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Banker's Magazine.

UNEMPLOYMENT CAN BE CURED

by

LT.-COL. K. E. EDGEWORTH

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FOREWORD

THIS book represents a serious attempt to offer an adequate and realistic solution to the problem of unemployment. Making use of statistics which have only become available in the past few years and of recent developments in economic theory, it analyses the underlying causes of unemployment and suggests appropriate remedies.

It is written in simple and straightforward language, and the author ventures to hope that it will not prove too difficult for the general reader.

K. E. EDGEWORTH.

BOOTERSTOWN,
CO. DUBLIN.
April, 1944.

CONTENTS

CHAPTER I

INTRODUCTION 11

A Statement of Faith—The Study of Economic Problems—Economic Doctrine—Economic Policy—Plan or No Plan—Types of Unemployment

CHAPTER II

THE ECONOMIC SYSTEM 18

Production and Consumption—The Allocation of Income—Capital—Saving—Investment—Economic Identities

CHAPTER III

MONEY BANKING AND CREDIT 27

The Meaning of Money—Monetary Reactions—The Period of Gold and Silver—The Banking System—The Period of Bank Money and the Gold Standard—The Period of Paper Money—Inflation—Modern Monetary Policy

CHAPTER IV

INTERMITTENT UNEMPLOYMENT 37

Business Cycles—The Minor Cycle—The Major Cycle—Public Works—Controlling the Major Cycle—Organization of the Control—The Building Cycle and its Control—The Reconstruction of Europe—Good and Bad Years

CHAPTER V

SPECIFIC UNEMPLOYMENT 49

The Depressed Areas—The Causes of Specific Unemployment—The Elimination of Specific Unemployment

CHAPTER VI

THE MULTIPLIER 53

The Facts—Theory No. 1—Theory No. 2—The Persistence of Change—An Extension of Theory No. 1

CHAPTER VII

OVER-SAVING AS A CAUSE OF UNEMPLOYMENT 61

Preliminary Note—Some Questions and Answers—Changes in Demand—Saving and Investment—Factors which Influence Investment—Factors which Influence Saving—The Equalization of Saving and Investment—A Remedy for Loss of Purchasing Power

CHAPTER VIII

THE EVIDENCE OF OVER-SAVING 74

Over-saving and Unemployment in the U.S.A.—Over-saving and Unemployment in Great Britain—A Comparison

CHAPTER IX

THE REDUCTION OF UNEMPLOYMENT THROUGH THE CONTROL OF SAVING AND INVESTMENT 82

Statement of the Problem—Individual Saving and its Control—Business Saving and its Control—Cumulative Influences and their Control—Government Borrowing—Government Spending—The Unemployment Problem in Great Britain—The Unemployment Problem in the U.S.A.

CHAPTER X

INTERNATIONAL FINANCE 100

The International Balance Sheet—The Means of Payment—Panic Money—International Investment—The Control of International Investment—International Accounting

CONTENTS

CHAPTER XI

INTERNATIONAL TRADE 107

Why International Trade is Necessary—The Penalties of an Unbalanced Account—The Small Country and its Difficulties—Balancing the Account—Import and Export Licenses—Free Trade is not a Solution—Tariffs—Subsidies—Quotas—Variable Exchanges—Relative Prices and International Trade

CHAPTER XII

THE PRICE LEVEL AND ITS CONTROL 119

Significance of the Price Level—Debtor and Creditor—Policy—Fluctuating Prices—The Costs of Production and Distribution—Wages and Prices—Profit—The Control of Profits—The Control of Prices

CHAPTER XIII

A WAGES POLICY 128

Existing Methods—Difficulties of the Existing System—Wages and the Cost of Living—A New Mechanism for the Adjustment of Wages—The Trend of Wages should be Upwards—The Composition and Powers of the Wages Tribunal—The Wages Scheme in Action

CHAPTER XIV

AGRICULTURAL PROBLEMS 135

Agriculture and Industry—The Flight from the Land—Low Earnings—Fluctuations in Output—Agriculture in Europe.

CHAPTER XV

SUMMARY AND CONCLUSION 141

A Summary—Over-saving and its Control—The Unemployment Problem in the U.S.A.—International Trade—Unemployment in the Smaller Countries—Organization for Victory—Conclusion

APPENDIX

Statistical Data for Great Britain, 1924-37 148

INDEX 153

CHAPTER I

INTRODUCTION

A STATEMENT OF FAITH

It is now generally realized that unemployment is a serious danger to the whole structure of modern democratic civilization. It causes an immense amount of individual suffering and distress, it leads to a great deal of international friction and misunderstanding, and it undoubtedly tends to create an international atmosphere which is favourable to war and unfavourable to peace.

The primary purpose of the present book is to arouse the widest possible interest in the problem of unemployment and to create a general belief in the doctrine that unemployment can be cured.

In asserting his faith and hope that unemployment can and will be cured, the author has no desire to minimize the difficulties which bestrew the path. The difficulties are many. But the fact that serious difficulties exist is no reason for abandoning either our faith or our hope. The proper attitude to adopt is to remind ourselves that the greater the obstacles to be overcome the greater will be the effort necessary in order to attain our goal.

THE STUDY OF ECONOMIC PROBLEMS

It is sometimes necessary to remind ourselves that the practice of exchanging goods and services existed thousands of years before it occurred to anyone to look for causes and explanations, and that the early economists were concerned, not with directing the course of events, but simply with explaining what was actually taking place.

Early attempts at control were not conspicuously successful, and the business men of the day were constrained to adopt the attitude which has been perpetuated in the phrase "*Laissez faire*" ("Leave us alone"). They believed, and with some justification, that the community would be better off if matters were allowed to adjust themselves under the natural operation of economic laws than if they were subject to political interference.

The industrial revolution, however, has wrought many changes, and has rendered obsolete mechanisms which worked well enough in other days and under other conditions, and the time has come when it is necessary that these earlier mechanisms should be replaced by others better suited to the modern conditions in which they are actually called upon to operate.

To suggest that these problems should be left to solve themselves under the normal influence of evolutionary forces is an insult to our intelligence. We have reason to believe that the human body possesses a certain inherent power of resisting disease, and that this power is capable of still further development through evolutionary forces which ultimately lead to the survival of the fittest. But we do not decide on that account that the prevention and cure of bodily diseases is unnecessary, and that the medical profession should be disgarded as of no account. There is no reason why a different attitude should be adopted towards economics. The problems may be more difficult, but there is no reason to believe that they are insoluble. The time has come when the theoretical economist should put his house in order. Where differences of opinion exist they should be dealt with by careful study, by scientific discussion and by an appeal to facts. If our knowledge of facts is insufficient, steps should be taken to increase it. By every means in our power the study of economic problems should be pushed forward until the economist is in a position

to say that he understands the nature of economic disease and that he is in a position to prescribe appropriate remedies.

ECONOMIC DOCTRINE

The first step in our campaign for the cure of unemployment is to determine the causes which have led to unemployment in the past, and the next step is to frame a policy which is calculated to eliminate these causes, or at least to reduce their potency, in the future. These are intellectual problems. Finally it is necessary to convince the ordinary citizen that the suggested policy is sound, so that he will exert himself to see that policy is translated into action.

Some cynic has remarked that, in the course of his experience, he has never found any two economists who are prepared to agree whole-heartedly on any single point of economic theory whatever. Like most epigrams, this statement contains an element of truth, and drives home its lesson by exaggerating the importance of the point which it is desired to emphasize.

The blame for this lack of agreement, however, does not lie entirely with the economists. Human actions and human institutions vary both in regard to time and place, and economic theory can never aspire to the wide generalizations which have been such a conspicuous feature of scientific progress in other fields of study. Economic theory is subject to a process of continual adjustment in order to keep pace with the ever changing conditions to which it must be applied. Differences between economists are mainly due to attempts to formulate generalizations and to apply them to a wider field than is justified by the actual facts of the case.

In recent years great strides have been made in methods of statistical analysis, and it has become possible to test the results of theory and thus to determine how far the theory under consideration is in fact applicable to the situation which is being discussed.

The present exposition of economic doctrine makes no special claim to either originality or infallibility. The author's aim has been to select what appears to be sound and reasonable and applicable to modern conditions, and to describe the mechanism which is thus revealed in as simple language as possible, emphasizing what is important and omitting what is unimportant or irrelevant.

This question of explaining economic doctrine in such terms that it can be generally understood and appreciated is of very great importance. Economic policy affects the lives of every group and every individual in the community, and the success of any particular policy depends, not only on the soundness of the policy itself, but also on the support and co-operation of the community as a whole. The realization of any scheme for the cure of unemployment requires that the individual citizen should understand the policy which is being pursued and should give it his whole-hearted support.

ECONOMIC POLICY

If the ignition system of a motor car is faulty, no useful purpose is served by tinkering with the carburettor, nor is there any justification for scrapping the whole machine and getting a new one. The proper course is to determine the cause of the trouble and apply the appropriate remedy.

The economic system of today is more complex than a motor car and less easy to understand, but the same principle is applicable. There is no need to scrap the existing system and try something entirely different, a proceeding which would lead to general confusion and would involve untold human suffering. The proper course is to determine the cause or causes of unemployment and then to formulate proposals which are calculated to remove them.

Whatever the appropriate policy may be, it is clear that it must be of such a character that it is fair to all classes in the

community, and, if it is to be successfully applied, it must receive general approval and support. Success cannot be attained if particular groups of people devote their energies to trying to grab a little more than their share. It is necessary that every citizen should recognize that he has duties as well as rights; a duty to other individuals, a duty to other groups and classes, and a duty to the community as a whole. By working together to secure general and continuous employment every group will benefit and will be better off than if the different groups devote their energies to quarrelling among themselves.

PLAN OR NO PLAN

Many writers on economic problems, and particularly those who are advocates of planning, are apt to insist that there must be a clear-cut decision between planning on the one hand and *laisser faire* on the other, but there is no justification for this attitude, and there are other alternatives which are certainly deserving of consideration.

Actually, the type of solution which will be suggested in these pages does not come under the description of planning, as ordinarily understood, and it certainly cannot be described as *laisser faire*. Perhaps it may reasonably be described as a policy of *economic control*.

A typical example of what is meant by economic control is the use which was made of the bank rate during the nineteenth century. It is unquestionable that this instrument of control was able to fulfil its purpose, and it is equally clear that it left in the hands of individuals entire freedom of action within the bounds which it imposed.

If it is granted, even for the sake of argument, that modern conditions require a larger measure of central control than was found necessary in the past, then our purpose must be, firstly, to ascertain what functions in the economic system are in need

of control, secondly, what purpose the control should be designed to fulfil, and finally, what instrument of control would appear to be most likely to prove effective.

TYPES OF UNEMPLOYMENT

Broadly speaking there appear to be four main categories of unemployment: intermittent unemployment, manifesting itself in the form of business cycles, specific unemployment, confined to particular industries or particular areas, general unemployment, associated with an apparent lack of purchasing power, and unemployment due to foreign competition.

The nature and cause of business cycles will be discussed in a later chapter.

The causes of specific unemployment are fairly obvious and easily understood. A typical example is to be found in the coal industry in Great Britain. At one time almost the only fuel for ships was British coal, and the gradual introduction of oil fuel led to a decline in the British coal industry, with consequent unemployment. Broadly speaking, the remedy in such cases must be to facilitate the transfer of the workers to other industries.

The outstanding example of general unemployment is to be found in the great depression which began in 1930 and reached its climax in 1932 and 1933. The depression extended throughout the world, but it reached its maximum intensity, and appears to have had its origin, in the United States. A variety of factors undoubtedly contributed to this upheaval, but the characteristic feature of the whole business was a wholesale collapse of purchasing power*, involving a reduction in the demand for goods and services, thereby leading to the discharge of workers and a further loss of purchasing power. It is

*The significance of the collapse in purchasing power (lack of dollars) is very strongly emphasized in the foreword to *The United States in the World Economy* (1944), published in the U.S.A. by the Government Printing Office, and reprinted in Great Britain by H.M. Stationery Office.

of vital importance that the fundamental causes of this loss of purchasing power should be laid bare, and that means should be devized for preventing its recurrence.

Foreign competition has been intensified by improvements in transport and by the increased efficiency of mammoth factories and methods of mass production, and it presses with peculiar severity on the smaller and less highly industrialized countries. To counteract the effects of foreign competition countries have been compelled, one after the other, to introduce and intensify systems of protective tariffs and other restrictions on international trade. Slowly but surely international trade has been strangled. It is essential that some modified system of international trade should be devized which will permit of an adequate exchange of goods and services without creating insurmountable difficulties for local industrial enterprises.

CHAPTER II

THE ECONOMIC SYSTEM

PRODUCTION AND CONSUMPTION

IN ORDER TO facilitate our subsequent discussion of its imperfections, it is convenient to begin with a brief sketch of the economic system as it actually exists.

The chief business of any community is the production and consumption of goods and services; we are all consumers, and most of us are producers.

If we go into a shop or look in at a shop window, we are apt to be impressed with the stocks of goods which are displayed for our inspection, and it is important to remember that these stocks are only an incidental feature of the business. The essential characteristic of trade and industry is a *continuous flow* of goods and services. Raw materials enter the factory and emerge as finished or partially finished goods, finished goods enter the shops and are sold and taken away by the customers to be used up in due course. The stream of goods and services may increase or it may diminish, but it never ceases, and its continuity remains unbroken.

The same principle applies also to the monetary aspect of these transactions. The exchange of work for money and money for goods is not an operation which has a beginning and an end; it is a continuous process involving a continuous use of purchasing power, and, in dealing with this matter of purchasing power, our attention must be focussed on the magnitude of the national income rather than on the national stock of money.

Perhaps the most appropriate picture of these processes, whether it be the flow of goods and services or the flow of purchasing power, is obtained by comparing them to a stream

entering a reservoir at one end and flowing out at the other. In considering the quantity of water available for use, changes in the level of the reservoir are important, but at the same time they are of less importance than the continual entry of fresh supplies.

A convenient starting point in our survey of economic activity is the sale of commodities and services, and this business has two aspects. In the case of a gardener who produces vegetables for market, for example, it is clear that the money which he receives for the sale of his vegetables represents to the community the value of his output, while to the gardener himself it represents income.

In the case of a large trading or manufacturing organization the two aspects of the transaction are still in evidence, but the business is more complex. Firstly, in estimating the contribution which is made by a trader or manufacturer to the national output, it is necessary to deduct from the total value of sales the value of purchases in the form of raw materials; it is the net output, measured by the difference between the value of sales and the value of raw materials, which is significant.

Secondly, the income of a large trading or manufacturing concern cannot be ascertained day by day; it is usually determined by making up the accounts annually. The result is that the actual income only becomes known after a certain lapse of time.

Thirdly, the income has to be allocated to various claimants.

Fourthly, owing to the delay involved in making up the accounts, the total income allocated does not agree precisely with the amount which is being earned. For our present purpose however, this discrepancy is not of serious importance, and it is not proposed to discuss it.

THE ALLOCATION OF INCOME

In a large trading or manufacturing firm, the business of

allocating the available income among the various claimants is one of the duties of the management. The various claimants are :—

(i) The workers, who receive their portion in the form of wages or salaries.

(ii) The government, which receives its portion in the form of taxes.

(iii) The shareholders, who receive their portion in the form of dividends.

(iv) The management may decide that a part of the available income is to be retained in the business to provide the capital necessary for expansion.

(v) The management may decide that a part of the available income is to be retained in the business to form a reserve.

The point to notice is that only a part of the income which accrues to the business as a result of its productive activities, that is to say the part covered by items (i), (ii) and (iii) above, is passed on to potential consumers. That portion of income which is retained in the business represents a form of saving. It may conveniently be described as *business saving*.

CAPITAL

In addition to a regular flow of consumable goods and services, the modern community needs structures and goods of a more durable character such as houses and other buildings, factories and machinery, roads and railways, and so forth. These things are commonly described as fixed capital. For the purpose of their business, traders and manufacturers need stocks of raw materials and of finished and partially finished goods, and at any given time there are always quantities of goods in transit by land, sea and air. These stocks of goods are described as *working capital*, or *inventories*.

Our present analysis takes the form of a study of the stream

of production of goods and services and the stream of purchasing power which people need in order to buy them, and we are not directly concerned therefore with the quantity and value of capital assets. The link between capital assets and this stream of production and purchasing power arises from the fact that additions to capital are a part of normal production and are paid for out of income.

The mechanism which is responsible for the growth of capital assets has two distinct aspects; on the one hand we must take account of the value to the community of the assets which are created, and on the other hand we must consider the motives which inspire particular members of the community to forego a part of their income in order to make their creation possible. The latter aspect of the business is commonly referred to as *saving* and the former as *investment*.

Theoretically it is possible for investment to be financed out of taxation, and in fact governments do save money to some extent, but in the main, governments are borrowers rather than lenders, and the creation of capital assets has been financed out of the voluntary savings of individuals and of business groups of one kind or another. Without voluntary saving the growth of capital assets, which has been such a conspicuous feature of the industrial revolution, would not have been possible.

In this connection it may be remarked that the need for voluntary saving in order to finance the expansion of capital assets is largely independent of the form of ownership and the form of management with which it is associated. When a factory is under private management, the investment is regarded as the property of the shareholders who have financed its construction out of savings, and a portion of the earnings is set aside under the title of profit, and provides a fund for the payment of dividends. When a factory is built and owned by the state, the construction is financed by means of a state

loan which is also derived from voluntary saving, and the payment of interest to the lenders is made by the state. The need for voluntary saving is the same in either case, and the expectation that the investment will earn interest is the same also.

SAVING

Saving may be defined as that part of income which is not spent for the purpose of consumption.

There are four chief types of saving :—

(i) Individual saving.
(ii) Business saving.
(iii) Government saving.
(iv) Saving by insurance companies.

It is also necessary to take into account what may be described as dis-saving. Each of the various types of saving has its own characteristics. Total saving is the sum of the various items of saving, less the various items of dis-saving.

In a democratic community the individual has the right to spend his income as he wishes, and he is also within his rights if he decides not to spend it. In so far as income is not spent on consumable goods and services it is said to be saved. The chief motive which inspires people to save is the desire to provide against future contingencies such as ill health, unemployment and so forth.

In the allocation of business income, that portion of income which is not distributed in the form of wages, taxes and dividends, but is retained in the business, is business saving. The purposes in view in retaining this money are two : firstly, the money may be retained for investment in the business, for it is usually easier to hold back money in this way, particularly when trade is expanding, than to raise fresh capital. Secondly, money may be retained to form reserves which can be utilised to tide over the losses which are apt to occur in times of depression.

Government saving, which takes the form of repayment of the national debt, is due to a desire to reduce the burden of the debt and is commonly regarded as "sound finance." The practice involves reactions the nature of which has not been generally realized; this aspect of the matter will receive further attention in due course.

Saving by insurance companies arises chiefly from the fact that expanding business involves increasing liabilities, and that these increasing liabilities must be covered by additional reserves. It appears to be inherent in the nature of an expanding insurance business.

To a very limited extent, savings can be hoarded in the form of gold, silver, jewels and so forth, but normally savings are used to provide the capital which is needed in business, or they can be lent to the Government or to individuals or groups of individuals for various purposes; and in that case the money earns interest, and the transaction is classified as an investment.

From the point of view of the investor, that is to say the person who has savings to dispose of, there are two points to be considered: the security of the capital invested and the rate of interest. Where high rates of interest are paid, it will usually be found that they can be regarded as compensation for depreciation or for the risk of loss on the original capital.

As already pointed out, savings provide the money necessary to finance the creation of capital assets, and it is clear that an adequate flow of savings is necessary if industrial expansion is to keep pace with the opportunities which are opened up by increasing knowledge and by the technical development which increasing knowledge has made possible. At the same time it is necessary to remark that savings may be excessive as well as inadequate. This aspect of the matter, which has not hitherto received the attention which it deserves, will be examined in detail in later chapters.

INVESTMENT

In considering the question of investment, a distinction must be drawn between the purchase of an existing investment and the use of money for the purpose of some new investment such as the construction of a house or factory or the issue of a new loan by the government. A transaction of the former type merely represents a change of ownership, while the latter involves the creation of new assets and is financed by means of saving. It is with new investments that we are chiefly concerned in our present investigation.

The chief types of new investment are :—

(i) Factories and industrial equipment.
(ii) Houses.
(iii) Railways.
(iv) Public works such as roads.
(v) Working capital, in the form of increased stocks of goods (inventories).
(vi) An excess of exports over imports.
(vii) Government loans.

Government loans differ from other forms of investment in that they do not necessarily involve the creation of any real assets. Instead of a share in the ownership of a railway or factory, the investor receives a bond which amounts to a promise that he will be paid by the state out of the revenue collected by taxation.

ECONOMIC IDENTITIES

There are two sides to any business transaction, and reference has already been made to the case of market gardening, where payment for vegetables is regarded as income by the grower and as expenditure by the consumer. When different descriptions are given to different aspects of the same group of transactions, these different descriptions may be referred to as identities. Broadly speaking, and subject to certain qualifica-

tions and reservations which will be mentioned in due course, the identities with which we are concerned are :—

Annual income is equal to the value of annual output, *and* Annual saving is equal to the value of annual investment.

As regards the first of these identities output is generalized so as to include both goods and services. The net output of a particular factory is the gross output less the value of raw materials used or consumed during production. Total output is the sum of all net output.

Since everything which is produced belongs to someone, total income should evidently be equal to total output, but a difficulty arises from the fact that the actual results of a year's trading or manufacture cannot be determined day by day or even week by week; the usual practice is to make up business accounts annually, and the distribution of dividends is based, not on the results of the current year, which are unknown, but on the results of the previous year. The result of this practice is that there is a discrepancy between earned income, which is equal to output, and allocated income, which is actually distributed in wages, salaries and dividends. This discrepancy is conveniently described as the *trading surplus* or the *trading deficit* as the case may be.

It is easily shown that trading surpluses occur when trade is expanding, and trading deficits when trade is contracting; over long periods surpluses and deficits tend to balance out. So far as our present investigation is concerned, this and other discrepancies between output and income are unimportant and will not be discussed in detail. While on the question of the identity of income and output, however, it must be noted that the existence of the identity gives no indication as to why output and income expand or contract. That is a different question which will be dealt with in a later chapter.

Turning to the second identity, that is to say the identity between saving and investment, the nature of the identity is

clear enough in simple cases, such as the construction of a house by an individual who pays for the construction out of his current income. In other cases saving may be carried out by one group of people, and the new investment which the saving has made possible by an entirely different group. Nevertheless, provided all relevant items are included, it is found that total saving is equal to total investment. The relationship will be discussed in greater detail in later chapters.

CHAPTER III

MONEY BANKING AND CREDIT

THE MEANING OF MONEY

IN ITS LITERAL sense the word money is applicable to coins of gold, silver and other metals and to paper notes authorized by the government and accepted as legal tender, but to prevent confusion this type of money is commonly referred to as cash or currency.

Closely allied to the currency and accepted by the business community all over the world as a means of settling their accounts is what is called *bank money* in the form of cheques.

In financial circles the word money is given a still wider meaning, and is applied to short term loans, or *credit* as it is sometimes called. It is in this sense that the word money is used when we say that money is cheap and plentiful.

MONETARY REACTIONS

The theory of money is a highly complex and technical subject, and it is of course impossible to discuss monetary theory in detail in a short chapter, but monetary factors are linked with the problem of employment, and particularly with the question of the price level, and it is necessary to make a brief reference to certain monetary reactions.

Money is necessary in order to facilitate the exchange of goods and services, and a lack of sufficient money tends to depress prices and to restrict the activity of trade. It is necessary therefore that the supply of money should be adequate; if the supply of money is inadequate, an increased supply will stimulate trade. But it cannot be inferred that an increase in the supply of money will always act as a stimulus to trade; if

trade is depressed and the supply of money is adequate, the cause of the depression must be sought elsewhere.

Similarly, in regard to short term lending or credit, an adequate supply of credit is a necessary factor in the conduct of modern business, but a lack of credit is not necessarily the cause of some particular depression in trade, and cannot normally be regarded as a cause of unemployment.

In discussing monetary reactions it is convenient to assume that monetary practice and monetary policy have passed through three main periods :—

(i) The period of gold and silver.

(ii) The period of bank money and the gold standard.

(iii) The period of paper money and international lending.

These three main periods must be considered separately.

THE PERIOD OF GOLD AND SILVER

A certain quantity of money being necessary for the normal requirements of business, it may well happen that the amount of gold and silver actually available in any country is inadequate, and the volume of business and the price level may be adversely influenced by lack of money. Experience shows that the activity of trade and the price level generally move in sympathy ; a shortage of money restricts trade and tends to lower prices, while a plentiful supply of money stimulates trade and tends to raise prices.

It is to be noted that gold and silver are essentially international currencies ; the fact that these metals may be coined into pounds, dollars or francs does not affect this fundamental postulate.

As is well known, an international metallic currency has the characteristic property that it brings about an automatic adjustment between imports and exports. A country which imports more than it exports loses gold, prices fall, imports are checked and exports are stimulated. It will thus be seen

that the quantity of money and changes in the quantity of money played a significant part during the period in question. The quantity of money exercised a controlling influence on the price level and on the activity of trade, and changes in the quantity of money provided a mechanism which secured a balance between imports and exports.

THE BANKING SYSTEM

The primary functions of the banking system are firstly, to take charge of the money lodged with the banks by their depositors, and secondly, to provide their depositors with facilities for the payment of their accounts. This is the monetary side of the business, and it is an essential feature of the arrangement that the banks must be in a position to supply their depositors with such quantities of currency as may be required.

Arising out of these responsibilities it is the normal practice for the banks to hold a quantity of cash amounting to about one tenth of the value of their deposits, and this holding of cash forms a currency reserve which can be taken up by the public should it be required.

The remaining nine-tenths of the money held by the banks is invested either in government securities or short term advances to customers. The nature of the banks' obligations makes it necessary that these assets should be capable of being converted into cash at short notice, and experience has shown that ordinary investment in industry does not comply with this requirement and is therefore unsuitable. Bank credit is therefore limited to those cases in which the borrower can offer adequate security.

An increase in the volume of deposits represents saving on the part of depositors, and an increase in the volume of the banks' assets represents investment. It is therefore clear that the broad effect of the banks' operations is to bring together

the people who have saved money, that is to say the depositors, and the people who wish to borrow money for the purpose of investment, either the government or business enterprizes as the case may be.

At the same time the banks have the power of influencing the volume of deposits and the volume of their own assets to a considerable extent. There are always certain types of investment whose merits are appreciably influenced by the rate of interest at which money is available for investment, and the bank rate, that is to say the rate at which the banks are prepared to lend money to approved borrowers, can therefore be utilized as an instrument for controlling the volume of investment and the activity of trade.

THE PERIOD OF BANK MONEY AND THE GOLD STANDARD

The development of the banking system and the practice of settling accounts by means of cheques instead of in cash relieved the currency of much of the work which it would otherwise have been called upon to perform, and it made possible an expansion of trade and industry which would hardly have been possible on a purely cash basis.

In this system, as we have already seen, the banks accept responsibility for repaying in cash any depositor who asks for it, but the amount of cash actually held is only about one-tenth of the total value of the deposits. The effect of the arrangement is that the total volume of money, that is to say the value of cash in circulation plus the value of bank money, is still proportional to the value of the national stock of currency, although it may be several times larger. During the growth of the system, while the banks were accepting an ever increasing volume of business, the quantity of money increased more rapidly than the quantity of gold, but eventually the ratio between the quantity of bank money and the quantity of currency, that is to say the quantity of gold, became stabilized,

and the quantity theory of money appears again in a new and more complex form.

As already mentioned, the banks, by the nature of their obligations, are compelled to hold a reserve of currency, and, if additional currency is absorbed by the public, the reserve is necessarily reduced. It is also reduced if imports exceed exports and gold is sent abroad in payment of the balance.

As a result of experience, the banks have found that an increase in the bank rate tends to attract gold to the banks and for two reasons. Firstly, the increase in the bank rate tends to discourage borrowers, trade falls off and the amount of currency in use by the public is reduced. Secondly, the high bank rate enables the banks to pay a higher interest on deposits and gold is attracted from abroad. By these means the volume of deposits is reduced, the currency reserve expands and the required ratio between the cash reserve and the total value of deposits is restored.

Alternatively, if the cash reserve is excessive the bank rate is lowered and trade expands again.

In either case the mechanism which is responsible for the balancing of imports and exports is still effective and operates in the manner already described.

THE PERIOD OF PAPER MONEY

Partly owing to the expansion of industry and partly owing to the inevitable rise in prices, there is a large increase in the demand for money in time of war, and this demand is inevitably met by the issue of paper money. After the first world war an attempt was made by Great Britain to restore the gold standard, but it failed, and the use of paper money continued.

Now the essential difference between gold and paper money is that the total volume of monetary gold in the world is limited, and can only be increased very slowly and with much

labour, whereas there is no limit to the capacity of the printing press. If the circulation of currency notes increases, the reserve held by the banks declines, and the currency authority prints more notes which are passed to the banks and restore their reserve again. If the circulation declines, the reserve held by the banks increases and the excess is returned to the currency authority for cancellation.

This development has had an important influence on banking policy and banking practice, but in order to appreciate the nature of the change it is necessary to go back to the period of the gold standard. Under that system the currency reserve was held to what was accepted as the correct figure by changes in the bank rate, and this procedure was adopted for the simple reason that it was found to work and that no other method of control appeared to be available.

Now while it is true that the bank rate can be used as an instrument for controlling the activity of trade, and that a high bank rate tends to restrict trade while a low bank rate tends to stimulate it, yet it must be noted that this form of control is essentially restrictive. Its operation resembles that of a throttle.

So long as there are opportunities for investment which are not made use of because the rate of interest appears to be too high, then a lowering of the bank rate will stimulate investment. On the other hand, when the opportunities for investment are exhausted, no offer of cheap money, however attractive, can make any difference.

In recent years there have been two definite changes in the situation. In the first place, the use of paper money has made it possible to provide all the currency that is needed, and there is no longer any need to employ any special control for the purpose of maintaining the currency reserve. In the second place, the growth of unemployment has rendered anything in the nature of a restrictive control extremely

undesirable. To make use of an analogy, the obvious policy is to open the throttle and leave it so, and this is what has actually been done. The accepted monetary policy is a policy of cheap money, that is to say a policy of low interest rates; the policy appears to be sound, and there is no reason to suppose that it will be reversed.

So far as the currency authorities and the banks are concerned, this policy is expressed by saying that their attitude is neutral. No attempt is made to influence either the volume of the currency or the volume of bank deposits. The conditions for the issue of currency, for the opening of deposits and for the granting of credit are fixed, or are allowed to vary only within narrow limits, and the volume of the currency and the volume of bank deposits is determined by the demands of the public. It will be noted that one effect of this new type of monetary policy is to eliminate the mechanism which was formerly responsible for balancing imports and exports. That mechanism has ceased to exist, and some new mechanism is required to take its place.

It will be noted also that paper money is essentially a national and not an international currency. It cannot be used for the settlement of international accounts. The problem of an international currency remains to be solved.

INFLATION

The words inflation and deflation, as applied to prices, simply mean an increase or decrease in prices as the case may be, and changes in prices of moderate amount are continually taking place in the ordinary course of trade.

Quite apart from this normal type of inflation, however, there is another type of inflation, due to abnormal causes, in which prices rise rapidly and continually and may reach astronomical figures unless steps are taken to check them, and it is to this type of disturbance that the name of inflation is commonly applied.

The characteristic feature of abnormal inflation is a loss of confidence on the part of the public in the value of money. Everyone tries to get rid of money and buy goods. The workman spends his wages as soon as he receives them, because he fears that prices may rise in the course of a few hours; the rich man buys jewels and furniture, invests his money in factories and buildings, and tries to transfer his savings abroad.

All this competition for a limited quantity of goods tends to increase prices and raises the cost of living, and demands for increased wages soon make their appearance. If these demands are acceded to, costs are increased and prices rise still further.

A rising price level places securities bearing a fixed rate of interest at a disadvantage and creates a tendency to sell securities of this type. As a corollary it becomes almost impossible to borrow money at a fixed rate of interest.

Rising wages and rising prices involve additional government expenditure, but taxation takes time to collect and extra taxes do not produce an immediate return. The result is that the government finds itself short of money and is compelled to borrow in a market which is unwilling to lend. This adds to the general lack of confidence, and increases the distrust with which people regard the paper currency and government promises to pay.

The flight of capital which usually accompanies a period of inflation causes a depreciation of the national currency on foreign exchanges, and increases the cost of goods and materials imported from abroad. This also contributes to the general rise in prices.

It will thus be seen that the phenomenon which we describe as inflation involves a number of factors which act and react on one another and form a vicious circle which, once formed, is very difficult to break.

In view of the number of factors involved in the process of inflation, it is not always easy to decide which factor has been

responsible for initiating the disturbance in any particular case. It is noticeable, however, that inflation in its earlier stages has nearly always been associated with a collapse of the foreign exchange and a flight of capital from the country concerned. It is evidently important that flights of capital should be discouraged and that the foreign exchange should be stabilized. These problems will be examined in due course.

Experience shows that the confusion caused by inflation and the unemployment which results from it are extremely unpleasant, and no country which has once been involved in such a disaster is anxious to repeat the experience. The ideal economic system of the future must certainly be designed in such a way as to reduce the risk of inflation to a minimum.

MODERN MONETARY POLICY

The flexibility of paper currencies, as compared with the inflexibility of gold and silver, has led to an important change in monetary policy and in the general outlook on monetary problems. The need for manipulating the bank rate and for restricting the activity of trade in defence of the currency reserve has disappeared. The idea of stimulating investment and encouraging trade by means of plentiful credit and low interest rates is now the dominating consideration. Modern monetary policy is a policy of cheap money.

It was believed at one time by certain enthusiasts that a policy of cheap money would solve the unemployment problem. Such views are by no means uncommon, even at the present day, but they are not supported by experience. Unemployment in the modern world is not due to lack of money or lack of credit, and a plentiful supply of money and credit has failed to supply a cure. Nevertheless, any return to the practice of raising interest rates and restricting credit for purely monetary reasons is unthinkable. The modern policy of cheap money is firmly established and is unlikely to be reversed.

Unfortunately, the advantage of cheap money, which is associated with this property of flexibility, is also associated with serious disadvantages. A paper currency lacks the inherent stability which is imposed by the physical limitations in the quantities of gold and silver, and there is always a danger of inflation. It is essential that means should be devized for removing this danger.

A second disadvantage is the disappearance of the mechanism which was formerly responsible for balancing imports and exports and for the control of international trade. This mechanism also depended on the physical limitation in the volume of international currency. In the absence of a workable mechanism for the balancing of imports and exports, international trade has been reduced to a state of chaos. The expedients which various countries have been compelled to adopt as a means of dealing with their own immediate difficulties have only added to the difficulties of the situation as a whole.

Some entirely new mechanism for the control of international trade is essential.

CHAPTER IV

INTERMITTENT UNEMPLOYMENT

BUSINESS CYCLES

IN RECENT YEARS a great deal of work has been done, particularly in the United States, with a view to ascertaining the characteristics of business cycles and the causes which underlie them.

In his recent book on "Fiscal Policy and Business Cycles", Prof. A. H. Hansen recognizes four types of business cycle :—

(i) The Minor Cycle, which has a period of 2 or 3 years.

(ii) The Major Cycle, sometimes referred to as the trade cycle, which has a period of about $8\frac{1}{2}$ years.

(iii) The Building Cycle, which has a period of about 17 years.

(iv) The Cycle of good and bad years, which appears to have a period of about half-a-century.

To secure full and continuous employment it is necessary that the amplitude of these fluctuations should be reduced.

In addition to fluctuations in the home trade, violent fluctuations also occur in international trade, and this aspect of the employment problem will be referred to in later chapters.

THE MINOR CYCLE

The minor cycle is usually attributed to fluctuations in the demand for consumption goods.

Consumption goods, and the raw materials and intermediate products required for their manufacture, are necessarily produced some months in advance of actual consumption, and production is based, not on actual consumption, but on predictions as to what consumption is likely to be some months ahead. The volume and pattern of consumption

cannot be foreseen exactly, and complete identity between production and consumption is not possible.

An unforeseen increase in demand causes a reduction in the stocks held by traders and manufacturers and stimulates manufacturers to increase their output, but some months may elapse before increased output actually makes its appearance. By the time that the arrangements made become effective, manufacturers have to provide for making good their depleted stocks, as well as for meeting the increased consumption. Having got behindhand, production ultimately outstrips consumption, inventories increase, and in due course production has to be checked again.

So long as the consumer is allowed his freedom of choice, fluctuations in the volume and pattern of production appear to be inevitable. In themselves these fluctuations, being of short period, are not of so much importance as the longer cycles, and it is difficult to see how they can be avoided. They must probably be accepted as a necessary factor in the mechanism which brings about an adjustment between supply and demand.

There is, however, another point. There is a strong tendency for the peaks and troughs of business cycles to coincide, and for one type of cycle to cause an increase in the intensity of another. A depression involves unemployment and loss of purchasing power, and traders and manufacturers may find themselves in possession of larger stocks of goods (inventories) than they consider necessary; at the same time they may find it difficult to obtain money to pay for these increased stocks, and there may be some forced liquidation. The manufacturer's reaction is to reduce output, which causes further unemployment, and the depression is accentuated. It is therefore important that traders and manufacturers should be given every encouragement and assistance to hold their stocks of goods during a depression instead of liquidating them.

Fluctuations in inventories are the inevitable result of fluctuations in the activity of trade, but there is reason to believe that the actual fluctuations are greater than is necessary. There is a tendency for traders and manufacturers to buy rather more liberally when it is believed that prices are likely to rise, but it is difficult to estimate the magnitude of this effect in practice. At the same time, there is considerable evidence that inventories can be brought down to an excessively low level by compulsory liquidation during a slump. Liquidation has also the effect of depressing prices, and this in turn throws an increased strain on the financial structure as a whole and causes further liquidation.

In this connection the policy of the banks is of considerable importance. In times of prosperity, when securities are overvalued, the amount of cover demanded should be high, so that, when prices fall, compulsory liquidation may be avoided.

Again, adequate help to traders and manufacturers who find themselves in difficulties during a slump is an important means of minimizing the effects of the depression, and this question of financial help is also, to a great extent, a matter for the banks. It is not so much a question of lowering the rate of interest as of giving credit on what would normally be regarded as inadequate security. In serious cases in which the risks involved are greater than the banks are able to cope with, government support may be necessary.

It will thus be seen that certain steps are possible which may be expected to prevent forced liquidation and thus reduce the severity of a slump.

THE MAJOR CYCLE

The Major Cycle, with a period of 5 to 11 years and an average period of between 8 and $8\frac{1}{2}$ years, involves fluctuations both in the output of consumable goods and in the output of capital goods. There is good reason to believe, however, that

the underlying cause is a variation in the demand for capital equipment.

Actually the statistical evidence shows that the outputs of capital goods and consumable goods vary in sympathy, but, to quote Prof. Hansen, "while investment and consumption fluctuate together, the movements are not entirely synchronous. Kuznets' data show that investment tends to lead, with consumption following."*

A reduction in output in any particular industry involves the discharge of workers and a corresponding reduction in national purchasing power. Consequently, a reduction in employment in one industry involves a sympathetic reduction in employment elsewhere, and in fact a general reduction in trade and industry as a whole. The ratio between the increase or decrease of output in the capital industries and the increase or decrease of national output as a whole can be determined statistically, and is commonly referred to as the multiplier.

As a result of investigations of this type, it is now generally agreed that the major cycle is to be attributed to fluctuations in investment, or more precisely to fluctuations in the demand for industrial equipment such as factories and machinery. Moreover, a fluctuation of this type is precisely what one would expect. Manufacturers of consumption goods are not likely to consider factory extensions when the demand for their output is falling off; factory extensions are naturally discussed when output is expanding. Also, increasing trade means increasing profits, and the money needed for financing investment is much more readily available when trade is expanding than when trade is contracting. It follows that the demand for new industrial equipment is essentially intermittent; it becomes insistent when trade is expanding, and it falls off when trade declines again.

* A. H. Hanson, *Fiscal Policy and Business Cycles* (1941), p. 49.

PUBLIC WORKS

The origin of the idea that public works should be regarded as a cure for unemployment is political. It is argued, and by no means without reason, that it is the duty of the government to provide work for those who cannot find it for themselves, but unfortunately abstract principles of this sort are without value unless they can be translated into measures which are of real value to the community. It has often been found in practice that the measures adopted for the relief of unemployment have been financially unsound, and have ultimately had to be abandoned, leaving the situation worse than it was before. Since the teachings of experience cannot be ignored, modern ideas regarding public works are less comprehensive and are restricted to what may reasonably be regarded as practicable.

A somewhat different type of argument in favour of public works may be summarized as follows. It being clearly established that periods of prosperity are associated with periods of active investment, it is argued that it is only necessary to create more investment in order to ensure a real and lasting prosperity. The argument unfortunately ignores the troublesome fact, which will be discussed in later chapters, that the volume of worth-while investment is limited and cannot be increased by wishful thinking.

Again, it has often been suggested that any serious decline in the demand for industrial equipment should be neutralized by a suitably adjusted programme of public works, and, viewed from the purely financial standpoint, the proposition appears to be attractive. The advocates of such proposals seldom go into details, however ; they simply say that it is the duty of the government to work out the necessary schemes and put them into effect, and it is only when an attempt is made to formulate a definite programme that it becomes

apparent that serious difficulties exist, and that the suggestion is by no means so simple as it appears at first sight.

If any scheme of public works is to be regarded as acceptable, it must satisfy two main conditions: firstly, it must provide employment for the people who are unemployed, and must not compete for the labour of those who are already in employment; and secondly, it must be designed to provide something which the community really needs, for it serves no useful purpose to set the unemployed to work on the construction of anything in the nature of an Egyptian pyramid.

In so far as there is a slump in the building industry, it is reasonable to suggest that unemployment may be relieved by the introduction of a government building programme, which should be continued until building by private enterprize is resumed, but the suggestion is subject to the proviso that the government programme is not so extensive as to destroy all prospect of the resumption of normal demand. It is clear, however, that the field for public works of this type is limited.

As regards public works of other types, conditions vary widely in different countries. In the more sparsely populated countries opportunities for public works can perhaps be discovered without much difficulty, but this is not true of the more densely populated and more highly industrialized countries, and it is in these countries that the problem of unemployment is actually more acute. Perhaps the easiest way to clarify the position is to consider some definite examples.

In the first place, it is necessary to exclude from consideration investment in factories and industrial equipment which would normally be purchased by private enterprise. A mere change of purchaser creates no new demand and does nothing to relieve unemployment.

Again, it is necessary to exclude projects which merely anticipate future requirements. Schemes of this character may

postpone a crisis, but in the end they are calculated to make things worse instead of better.

Again, it may be suggested that a falling off in the demand for industrial equipment might be neutralized by a programme of road construction. In this case the difficulties are that the unemployed workmen have not the technical skill which would be required in their new employment, nor is it likely that they would be domiciled in the right place. With sufficient effort it may be possible to overcome these difficulties, at least in part, but it is clear that the suggested expedient is not in fact the correct solution.

Obviously the thing to aim at is continuous employment both in road making and in the production of industrial equipment, and no emergency expedients can ever take the place of regular and orderly production.

Perhaps the chief difficulty about the whole business of public works arises from the fact that the proposals attempt to serve two distinct and mutually inconsistent purposes—the relief of unemployment and the production of something useful. When actual schemes are examined, it is inevitably found that the proposals which comply with both these requirements are few and far between. Schemes which are reasonably useful will be found to make considerable demands on industries which are already fully employed, a proportion of the money will be allocated to profit and will not therefore be paid out in wages, and so on, so that only a portion of the money spent on public works actually finds its way into the pockets of the unemployed.

The fact is that the idea of a public works programme, capable of neutralizing the periodical slumps in the demand for industrial equipment, is based upon certain assumed conditions which do not actually exist in practice. In particular cases there may be particular schemes which are helpful and whose adoption is desirable, but there is no evidence that a pro-

gramme can be devized, under normal conditions, on the extensive scale which would be necessary in order to provide an adequate solution to the unemployment problem.

CONTROLLING THE MAJOR CYCLE

If the suggested explanation is correct, and if we are further correct in supposing that fluctuations in ordinary business demand for capital equipment cannot in practice be neutralized by a programme of public works, then it becomes evident that the remedy for this particular trouble is to place the future demand for industrial equipment under some form of general control designed to suppress its former intermittent character and to render it more nearly uniform.

Twenty years ago such interference with the freedom of individual manufacturers would have been regarded as rank heresy, but planning is now the order of the day, and this question of regulating the demand for industrial equipment would seem to be a fairly simple and straightforward problem in national planning.

On the other hand there is no insuperable objection to the suggestion that the output of industrial equipment should be subjected to some form of general control, and opposition to such a proposal appears to be chiefly due to an inherent dislike of control of any kind and to the business man's natural inclination to favour a policy of *laisser faire*.

The need for new industrial equipment at any particular time in any particular community actually depends on a variety of factors, technical and otherwise, which are not amenable to control, and which must be accepted as part of the data which must form the basis of our proposals for the national planning of trade and industry. The first duty of a controlling organization would be to make an estimate of the probable total requirements of the community in industrial equipment for, let us say, the next ten years. The estimate

would be based on past experience, modified by a knowledge of any special factors of a temporary character, and its purpose would be to determine the average requirements over a reasonably long period.

The second duty of the controlling organization would be to adjust the annual demand for industrial equipment so as to make it agree as closely as possible with the estimated average. If the actual demand were excessive, a system of priority would have to be established and the less urgent orders would have to be held over. On the other hand, if the actual demand were too low, an attempt would be made to anticipate future requirements and put in hand work which might otherwise be postponed.

In making these adjustments some account would also have to be taken of the need for adjusting the pattern of demand to the existing pattern of the organization for the production of industrial equipment. Lack of demand for the goods produced by one branch of industry is not necessarily helped by increasing the demand in another branch which happens to be fully employed.

It is not desired to minimize the difficulties which would be met with in creating the suggested control: the point to be emphasized is that control is necessary if the cycle is to be avoided or seriously reduced.

ORGANISATION OF THE CONTROL

One suggestion for the control of the demand for industrial equipment is that the management of all public utilities and some of the more important industries should be placed in the hands of public boards. It is assumed that these boards would be more amenable to central control than boards of management appointed by private individuals, and it is argued that the policy adopted by the public boards could be adjusted in such a manner as to neutralize irregularities in that portion

of the demand which would still be controlled by private enterprize. There is much to be said for this proposal, but, in considering such revolutionary changes in the management of industry, there are evidently other aspects of the matter to be considered as well as the control of the trade cycle.

In any case, even if an appreciable proportion of industrial activity is placed under public management, it is reasonable to argue that it is much sounder policy to stop industrial fluctuations at their source than to neutralize them after they have developed. Such control might be either voluntary or compulsory.

The "consumers" of industrial equipment are the manufacturers of other goods, and the control of output must involve consultation between these other manufacturers and the actual producers. The organization for control would have to provide for the representation of both these interests. What suggests itself is the establishment of two boards of control, the one representing the producers of industrial equipment and the other the users, and these two boards would have to come to an agreement as to the volume of output which would be adequate for the national requirements.

If demand exceeded the agreed volume of output, rival claims would have to be dealt with by a system of priority. Wartime experience of restrictions and the appearance of black markets shows clearly that the task of control would not be easy, and it is again necessary to postulate a large measure of goodwill if the proposed system of control is to be effective. At the same time it may be remarked that, even under existing conditions, schemes may have to be postponed for lack of capital, so that postponement to meet the requirements of the control need not be regarded as unduly burdensome.

Beyond this, it can only be said that the actual organization must depend on the political and financial institutions in each individual country, and it is neither necessary nor desirable to

go into greater detail. What is needed is a firm determination on the part of all concerned to make the scheme a success. If the will to succeed exists, the appropriate means can certainly be found.

THE BUILDING CYCLE AND ITS CONTROL

The average duration of the cycle in the building industry appears to be about 17 or 18 years, or twice the average period of the major cycle.

One of the chief factors involved in the cycle would seem to be a corresponding fluctuation in rents, but other factors, such as the cost of building, are also involved.

The elimination of the building cycle would appear to be another fairly simple and straightforward problem in national planning, the general principle being that an estimate should be made of the national requirements over a fairly long period, and the actual programme of construction should then be held as closely as possible to the estimated average. This does not mean of course that the estimates prepared in any one year must be rigidly adhered to in subsequent years; on the contrary, they should be revized at fairly frequent intervals. The essential point simply is that the programme of building construction should be controlled in such a way that factors of a purely temporary character are not allowed to exercise an undue influence on the course of events.

In many countries the government is responsible for a considerable proportion of the national building programme, and in that case abnormal activity in industrial building construction might no doubt be neutralized by a slowing down of government construction and *vice versa*. The control of the building cycle, in some respects at least, would appear to be easier than the control of the trade cycle.

THE RECONSTRUCTION OF EUROPE

Owing to the extensive destruction caused by aerial bombing in the present war, it is clear that building activity will be abnormally high for many years to come. The problem of reconstruction would seem to divide itself into three main stages.

Firstly, there will be the need to provide the greatest possible amount of accommodation, perhaps of a temporary character, to shelter those whose homes have been destroyed.

Secondly, there will be a period of intense building activity designed to replace that which has been destroyed and to provide a supply of houses which would be accepted as adequate in accordance with modern standards. During these two periods proper organization should prevent unemployment, and the limiting factor will be the amount of money which can be made available by a combination of saving and taxation.

Thirdly, there will be a period of declining building activity as the period of reconstruction merges into the period of normal replacement. This period will be much more difficult. It will involve a transfer of workers from the building trades to other spheres of activity, and a reduced volume of saving. These problems are dealt with elsewhere.

GOOD AND BAD YEARS

The cycle of good and bad years has a period of about half a century, and the good years appear to be associated with large scale industrial development such as the construction of railways. It is evident that these long period fluctuations can neither be foreseen nor controlled, and must be accepted as unavoidable.

The existence of long period fluctuations should simply be regarded as a reminder that the economic system must be so devized as to make it flexible, so that it can adjust itself to slow changes in the volume of investment.

CHAPTER V

SPECIFIC UNEMPLOYMENT

THE DEPRESSED AREAS

DURING THE INTER-WAR period there grew up in Great Britain an unemployment problem which was commonly referred to as the problem of the depressed areas.

The effects of the decline in British exports which was noticeable in the decade 1919-28, and which was accentuated by the great depression in the years 1929-32, were not equally distributed; there were certain industries which were much more seriously affected than others. There was a time when Great Britain supplied nearly 80 per cent. of the world demand for certain textiles, and this industry was seriously affected by the growth of tariffs in foreign countries. The coal trade in its turn was handicapped by the ever increasing use of oil and other fuels, and particularly by the increased use of oil for the propulsion of ships. The problem of the depressed areas was largely due to the decline in the demand for the products of these two industries.

It is particularly noticeable that the period of serious unemployment in the depressed areas continued even after the process of recovery had led to a considerable restoration of prosperity in other parts of the country.

THE CAUSES OF SPECIFIC UNEMPLOYMENT

The problem of the depressed areas is not by any means an unusual one. Indeed it is typical of a particular form of unemployment which is always liable to make its appearance in a progressive economic system, and which may conveniently be described as *specific unemployment*.

In an age of progress, new products and new processes are invented, the demand for older products declines and the older processes have to be scrapped ; and these changes give rise to unemployment in particular industries. When the declining industries are identified with particular localities, unemployment is localized in these particular regions, and we have the problem of the depressed areas.

Under favourable conditions the unemployed may be absorbed into new industries, but, under less favourable conditions, unemployment may persist for many years and may be the cause of a great deal of hardship.

The general character of the problem may be set out fairly simply. Private enterprise, acting under the stimulus of the profit motive, has always been reasonably effective in creating new industries and in arranging for the expansion of existing industries to meet any increase of demand, and it has been able to provide such equipment as has been necessary for that purpose, provided that there has existed an adequate supply of trained workers or of people suitable for training, and that houses for the workers have been available near the factories. It is not regarded as the function of the industrialist or the trader to provide houses for the workers, nor has it been the practice to make any special efforts in regard to training. The normal system of recruiting workers for industry is to take people who are young and therefore adaptable, and pay them low wages until they become efficient. It has never been the practice to take people from declining industries and retrain them in some new trade. Nor for that matter has it been regarded as the duty of the government to interfere with the location of industry or the training of workpeople.

As regards housing, the existing system is that construction is in the hands of private enterprise or of local authorities whose outlook is necessarily confined to the needs of their own particular locality.

It will thus be seen that the transfer of workpeople from one industry to another is beset with certain obstacles which have to be overcome if the surplus labour force in the depressed areas is to be restored to active employment; these obstacles are :—

(i) The people transferred need training in their new trades, and it must be assumed that many will prove less adaptable than the younger recruits who are learning their trade for the first time.

(ii) After training, the transferred workers may take longer to acquire the normal standard of proficiency.

(iii) While under training and while still below the normal standard of proficiency, the transferred workers, who would be older than the ordinary recruits, would expect to be paid nearly full wages.

(iv) The most attractive sites for new factories may not be located near to the houses in which the unemployed happen to be living.

THE ELIMINATION OF SPECIFIC UNEMPLOYMENT

The problem of unemployment in the depressed areas in Great Britain attracted a good deal of public attention at the time, and provoked a certain amount of government action, but there was a disinclination to spend money, and there was also a great deal of reluctance when it came to interfering in any way with the location and organization of industry. Such action as was taken was therefore inadequate and ineffective.

As soon as it is agreed, however, that the obstacles in the way must be overcome, that they can be overcome only by some system of national planning, and that it is much cheaper in the long run to cure unemployment instead of maintaining the unemployed in idleness, then the solution of the problem becomes possible, even if it cannot be claimed that it is simple or easy.

The national plan would evidently include the following items :—

(i) A scheme for training the unemployed workers to new trades in which they will be able to secure employment.

(ii) The payment of wages to those under training, and the payment of full wages to those who have been trained but who have not yet acquired complete proficiency.

(iii) Some measure of control over the location of industry so as to take account of the actual location of the unemployed.

(iv) Some measure of control over the housing programme so as to take account of the requirements of industry.

The form of organization which would be appropriate for carrying those proposals into effect would depend upon the political and economic structure of the community concerned, and would vary widely in different countries.

It is sufficient to remark that, if the community as a whole is determined to make such a plan effective, and if particular groups co-operate whole-heartedly to secure the desired end, the creation of the necessary machinery is unlikely to involve any insuperable difficulties.

CHAPTER VI

THE MULTIPLIER

THE FACTS

THE NATIONAL INCOME of any community can be measured statistically, and the proportion of national income which is saved and spent on new investment can also be measured. The ratio between these two quantities varies considerably from year to year. The mean value of investment both in Great Britain and in the United States during the period 1919-1939 was in the neighbourhood of $7\frac{1}{2}$ per cent., or 1 in 13·3; the maximum value in the United States during the prosperous years 1926-1929 was 12 per cent., or 1 in 8·3.

When fluctuations are taking place it is possible to compare, not only the absolute values of saving and income, but also the rates of change in these two quantities. Thus we can say that the increment of saving is a certain percentage of the increment of national income, or we can use the reciprocal of this figure and say that the increment of income is so many times the increment of investment. This last named figure is called *the multiplier*. Its value is usually found to lie between 2 and $3\frac{1}{2}$.

There are two distinct theories of the multiplier. The first is due to Kahn* and is discussed by Keynes in his book *The General Theory of Employment, Interest and Money*†. The second is due to Colin Clark‡.

Both theories appear to contain a considerable measure of truth, and both theories are helpful in illuminating the modern economic system in action and in suggesting measures for its control.

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* *Economic Journal*, June, 1931
† Chapter 10
‡ *The Economist*, September, 1938, p. 435

THEORY NO. 1

When a manufacturer decides to increase his output and engages additional workers for the purpose, the purchasing power represented by the wages of these additional workers is added to the existing purchasing power of the community, and, from the nature of the case, all this additional purchasing power (or nearly all) is immediately utilized for the purchase of commodities and services. The increased demand for commodities brings about increased output, and the result is that increased investment, involving an increased production of capital goods, is necessarily followed, with only a brief delay, by an increased output of consumable goods. The increase in national output and national income is the sum of these two effects, and the multiplier is the ratio between the increment of output and the original increment of investment which was instrumental in causing the expansion.

Similarly, a falling off in investment involves a loss of purchasing power and a corresponding but amplified reduction in national income.

This theory is in close conformity with, and is supported by, Prof. Hansen's observation, already quoted, to the effect that "the statistical data during the last two decades tended to support the thesis that the active dynamic factor in the cycle is investment, with consumption assuming a passive lagging rôle."

It will be observed that, in this form of multiplier theory, the change in the volume of investment is regarded as the cause and the change in national income as an effect which arises out of the change in investment.

THEORY NO. 2

When trade is expanding business profits increase. The manufacturer's reaction to the knowledge that business is expanding and that additional profits are available is to bring

forward various schemes for the improvement and expansion of his factory which have been held up for lack of funds. In other words an increase in national output (income) leads to increased investment.

Colin Clark* has made use of this idea and has traced a relationship between the volume of national income in one year and the volume of investment in the year following.

For the purpose of calculating his multiplier, Colin Clark assumes that fluctuations in saving are due to fluctuations in business saving only, and that individual and institutional savings remain sensibly constant. In the course of the analysis it is pointed out that only a proportion of any increase in income is paid out, and that the balance makes its appearance in the form of "gross profits." A portion of this increase in gross profits is distributed and the remainder is saved and becomes available for the purpose of investment.

In making the actual calculations it is necessary to allow for delayed spending and for the influence of imports and exports, but for our immediate purpose a simplified statement of the theory will be sufficient.

Let p = the proportion of any increment of the national income which is allocated to profit.

Let q = the proportion of this profit which is saved. Then the increment of business saving in terms of the increment of total income is pq.

In Great Britain in the years 1929-33 the value of p was ·855†, and the value of q was ·54‡, so that pq was ·461. The value of individual saving at 3 per cent. was ·145 x ·03 = ·004, and total saving was ·465. The corresponding value of the multiplier, which is the reciprocal of pq, was 2·15, agreeing closely with Colin Clark's more precise value of 2·08.

* *Loc. cit.*
† *Loc. cit.* p. 440
‡ Colin Clark, *National Income and Outlay*, p. 225

In the years 1934-37 the value of p was $\cdot 55$* and the value of q was $\cdot 54$†, so that pq was $\cdot 297$. Add $\cdot 45 \times \cdot 03 = \cdot 013$ for individual saving, to make a total of $\cdot 31$, and the multiplier becomes $3 \cdot 22$.

Colin Clark claims that his theory can be used to predict the activity of trade twelve months ahead, but the theory has also certain other implications which are of great significance in connection with our present enquiry.

It will be noticed, for example, that Clark's multiplier, which defines the magnitude of increases or decreases in business saving in terms of corresponding changes in national income, depends on two factors, represented by the symbols p and q, and that these factors, namely the proportion of any increment of national income which is allocated to profit and the proportion of this profit which is saved, may be amenable to control.

When we come to the problem of controlling business saving, it will be necessary to consider what influences can be brought to bear to modify one or other of these factors, or both of them.

It will also be observed that, in this form of the theory, the change in national income is regarded as the cause and the change in investment as the effect which arises out of the change in income.

THE PERSISTENCE OF CHANGE

If the two theories of the multiplier are taken together, they serve to indicate the existence of a double link between changes in the volume of national income and changes in the volume of investment; an increase in investment tends to cause a general expansion in output and income, and an expansion in national income tends to increase business saving

* *The Economist*, September, 1938, p. 440
† *National Income and Outlay*, p. 225

and consequently the volume of investment. Any change, whether upward or downward, tends therefore to be cumulative; once the upward or downward trend is started it tends to persist, and the duration and intensity of the disturbance, whether boom or depression, depends on the degree of persistence.

In the previous chapter it was argued that fluctuations in investment are the cause of fluctuations in national output, and it was suggested that fluctuations in output could be avoided, or at least reduced, by establishing some sort of control over the rate of investment. Multiplier theory suggests an additional line of attack: it suggests that the intensity of a depression can be reduced by weakening the links which bind output to investment and investment to output.

Since the intensity of a depression is of much more serious importance than the intensity of a boom, it is convenient to approach the matter from that angle. Let us first examine the link between investment and output which arises from changes in purchasing power.

In recent years a considerable organization has been developed, particularly in Great Britain, for the relief of unemployment. Now it will be seen that, if the worker's income suffers no diminution when he becomes unemployed, there will be no loss of purchasing power at all, and this link between investment and national income will be broken; under such conditions there will be no general decline in demand and no tendency for the initial disturbance to spread. On the other hand, if the unemployed worker receives no assistance at all, the loss of purchasing power will be a maximum, and the tendency for the depression to persist and spread to other industries will be large and cumulative.

It is therefore clear that the degree of persistance of the decline depends very largely on the extent to which the workers' income is diminished by unemployment, and that

an effective scheme for unemployment relief is an important barrier against the spread and intensification of a depression.

Let us now turn to the second link between investment and national income, that which arises from the stimulus imparted to investment by expanding trade.

When the opportunities for investment have been exhausted by a boom, and when trade is on the down grade, schemes for new enterprizes are naturally laid aside. To a limited extent, but only to a limited extent, the gap in normal investment may be bridged by schemes of public works, or again a slump may be regarded as a "hang-over" from the undue exuberance of the preceding boom, and schemes for controlling and equalizing the rate of investment are certainly worthy of consideration. But there are also other aspects of the matter.

During a period of depression the stock of goods which must be held by traders and manufacturers is less than in normal times, and there is a tendency towards the reduction of inventories, whereby output (and employment) is reduced below what is needed to supply current consumption. This process is a form of disinvestment. To some extent dis-investment is of course inevitable, but, when a depression assumes serious proportions, there is a tendency for the weaker firms to be driven into liquidation, so that their stocks of goods are thrown on to the market. If financially strong firms would hold their inventories during the depression at as high a figure as possible, and if assistance could be provided for firms which are basically sound but financially weak, the intensity of a depression would be materially diminished.

There is also another factor of a somewhat similar character. The upkeep of factories and machinery in good working order involves a considerable annual expenditure for repairs and maintenance. In periods of depression there is a tendency to hold over this type of work, and this practice represents another form of dis-investment. Any steps which can be taken

to sustain a normal expenditure on repairs and maintenance also tends to reduce the intensity of a depression.

AN EXTENSION OF MULTIPLIER THEORY NO. 1

If Theory No. 1 is examined, it will be noticed that there is nothing in the general character of the argument which compels us to limit it to the case of investment.

Instead of assuming increased investment, we may assume that people, who originally saved their money and ate bread, which is cheap, decide that in future they will eat cake, which is more expensive. The change in demand involves the employment of additional workers, and the whole argument which we have applied to the case of increased investment is equally applicable to the case of increased consumption. From the purely theoretical standpoint, there are two distinct ways in which increases may be produced in the national income, depending on whether the initial cause is increased investment or increased consumption, the latter being equivalent to reduced saving. In either case the multiplier theory is applicable, that is to say, the ultimate expansion of national income is considerably greater than the initial increase of output in which the expansion originated.

The inference to be drawn from this argument is clear. The link between national income and investment which arises from the change in purchasing power, and which is postulated in multiplier theory No. 1, is not unbreakable.

The critical point in a cycle is reached when actual investment is proceeding at such a rate that the opportunities for worth-while investment are being absorbed as rapidly as they appear. At this point what actually happens is that investment continues to expand until the opportunities for worth-while investment are exhausted, and the boom is succeeded by a depression. What ought to happen is that there should be, not a further increase in investment, but an increase in

consumption. In other words, saving should not be allowed to increase beyond the amount which is needed in order to finance the available opportunities for worth-while investment.

CHAPTER VII

OVER-SAVING AS A CAUSE OF UNEMPLOYMENT

PRELIMINARY NOTE

EXPERIENCE OF INDUSTRIAL development, extending over more than a century, shows that trade booms and periods of prosperity are followed by slumps and periods of depression, and it is generally agreed that the prospects of full and continuous employment would be greatly improved if these fluctuations could be eliminated.

Again, the problem of the depressed areas makes its appearance from time to time, and it is necessary to devize measures for dealing with it.

In addition to these particular causes of unemployment, investigation shows that there exists what is sometimes referred to as "the hard core of unemployment", due to a variety of causes, and of such a character that it does not appear to be amenable to treatment. In Great Britain this hard core of unemployment has been estimated to be in the neighbourhood of 5½ per cent.

It has been gradually becoming clear, however, that these obvious causes of unemployment are not the whole story. Evidence has been accumulating which goes to show that there exists some other factor, of a more general character, which must be regarded as responsible for the wide gap which exists between actual employment and the degree of employment which is theoretically possible, and it is now becoming generally recognized that this general tendency towards unemployment is due to over-saving.

The belief that over-saving may be one of the causes of

unemployment is not new. It has been discussed by various writers, and has received a certain amount of support, but it has not always been presented in such a form as to command any general measure of assent.

In the present chapter over-saving will be defined, and a description will be given of the mechanism by means of which saving is able to exert an influence on the volume of output and on the volume of employment, and a theory will thus be formulated which will help, it is hoped, to remove outstanding difficulties, and which will thus serve to reveal the true character and significance of this widespread and disastrous ailment of the modern economic system. The theory will then be applied to interpret the actual course of events in recent years, with a view to providing a consistant and adequate explanation of what has actually taken place, both in Great Britain and in the United States.

The theory may be stated in outline as follows. The results of productive work are two-fold: firstly, it creates and distributes a stream of goods and services which eventually become available for use; secondly, it releases an equivalent stream of purchasing power or income. Ultimately the stream of production meets the stream of purchasing power, and the goods and services are sold to the consumers. It is at this point that trouble may arise.

If the whole of the available purchasing power is utilized, the goods and services are absorbed and production proceeds without interruption. If the whole of the available income is not used, some of the goods and services which have been produced remain unsold, and production is adjusted accordingly and declines. If, on the other hand, purchases of goods and services exceed income, production is stimulated and expands.

What happens is that a certain proportion of income is earmarked as "saving", which means that it is only available

for the purpose of investment. The opportunities for worth-while investment are limited. If the volume of saving exceeds what is needed to finance the available opportunities for worth-while investment, production is restricted and unemployment is inevitable.

SOME QUESTIONS AND ANSWERS

As a starting point in our search for some general cause of unemployment, associated with a general lack of purchasing power, let us pose the question : Why does not the volume of output increase until all available workers are fully employed ?

Decisions as to whether the output of any particular business is to be increased or decreased rest with the management ; our question may therefore be put in the form : why does the manager of any particular business decide to increase or reduce his output ? The answer to this question is that the manager of a business adjusts his output to meet what he estimates to be the demand. If he over-estimates, his stocks of unsold goods increase and give him warning that his output must be reduced ; alternatively, if his stocks fall below normal, it is an indication that output is too low and must be increased. Our question thus takes on a new form : what is the cause of changes in the demand for goods and services of various descriptions ?

It has sometimes been suggested that the volume of demand is under the control of the manufacturer, and that he can increase or reduce demand by lowering or raising prices, and attempts have been made to construct theories of industrial fluctuations on this basis. These attempts have failed, because in fact demand does not respond to changing prices to the extent which would be necessary to make this mechanism effective. The explanation of the changes in demand which actually occur must therefore be sought elsewhere.

CHANGES IN DEMAND

From the manufacturer's or trader's point of view the purchase of goods and services is "demand", but from the point of view of the purchaser it is "expenditure". Let us consider then what factors determine the volume of expenditure.

Many individuals in a modern community, indeed perhaps the majority, have incomes which are inadequate for the purchase of their requirements, and they spend the whole of their incomes as soon as they receive them, or at least very soon afterwards.

The richer members of the community, on the other hand, are in a different position. They have a margin of income over and above that which they really need, and they can afford to save a part of their income should they wish to do so. Alternatively, they can sell some of their property or securities, or they can borrow money, and thereby spend more than their incomes.

Taking the community as a whole the position is this. Consumption may exceed the output of consumable goods so that inventories decline, investment in house property may exceed the output of new houses so that unsold houses are bought up by investors, and investment in factories and machinery may exceed the output of such items so that finished and partially finished factories and machinery are bought up and pressed into service. Thus total expenditure, which is made up of consumption and investment, may exceed total output (which is equal to income), and output is stimulated. Alternatively, expenditure may be less than output, so that output is discouraged.

We thus arrive at the following important proposition. *If the community spends more than its income, output is stimulated and expands; if the community spends less than its income, output is discouraged and contracts.*

In order to pursue our investigation, however, it is necessary to state this proposition in a somewhat different form, and some digression is necessary.

SAVING AND INVESTMENT

We begin by postulating that total saving is equal to total investment. The items which go to make up saving and investment have already been set out in chapter II.

Investment may also be classified as voluntary or involuntary. The distinction arises in this way :—

It is impossible in practice for traders and manufacturers to make precise estimates of future demand, and to control the output and sale of goods in such a way as to ensure that inventories will be maintained at the precise amount which is regarded as desirable. Unforeseen changes may occur in demand, and it is usually impossible to correct the volume of output immediately.

If there is an unforeseen decline in demand, for example, inventories will increase for a time, until steps can be taken to reduce output and bring stocks back to normal. Meanwhile, manufacturers have to meet the cost of the increased inventories, and the extra money needed for financing the business must be found out of savings and must be classified as an investment, but it is not voluntary investment. Something has happened which is not the result of any deliberate decision on the part of the management to increase their investments, but is the result of decisions made by consumers and investors acting quite independently of the manufacturers and traders immediately concerned.

It thus appears that investment in inventories can be of two kinds : voluntary investment, due to decisions by the management that inventories should be increased, and involuntary investment, due to a decline in demand. From the accounting point of view these two types of investment are identical,

but from the point of view of subsequent reactions they are entirely different. If investment has been decided on deliberately there will be no further action, but if investment is involuntary and unwanted, it will be followed by steps designed to reduce output.

Similarly, inventories may be deliberately reduced because they are considered to be excessive, in which case no further action will be taken, or they may fall on account of an unforeseen increase in demand, in which case dis-investment is involuntary and will be followed by steps designed to increase output.

These considerations apply particularly to goods intended for consumption, but they apply also, with some variations in detail, to other branches of trade and industry.

In the building trade, for example, the builder of houses has a certain amount of capital invested in materials, equipment and partially finished houses, but it is no part of his business to retain the ownership of houses after they have been completed. As soon as a house is completed the builder tries to sell it, either to someone who is able to buy it and live in it, or else to someone who is prepared to buy it and let it to the actual occupier. The money paid for the house then becomes available for the construction of another one.

If the volume of investment in house property falls off, the builder may find that finished houses are left on his hands. From the voluntary investor in equipment, materials and partially finished houses he may become an involuntary investor in house property. Under such circumstances it is evident that he will stop building, and will wait until he has disposed of the completed houses before starting again. The significant decision as to whether new houses are to be built or not is in fact made by the investor in house property rather than by the builder of houses.

It will thus be seen that the proposition set out in the previous section can be restated in somewhat different form. *If voluntary investment exceeds saving, output is stimulated by a fall in inventories and expands ; if saving exceeds voluntary investment, output is discouraged and contracts.*

This relationship between saving and investment has sometimes been described, perhaps not very happily, by saying that a tendency for investment to exceed saving causes increased output, and a tendency for saving to exceed investment causes a reduction of output, but it has not been easy to understand how such a tendency can be significant if saving and investment are identically equal. The explanation given above will no doubt be helpful in clearing up this difficulty.

FACTORS WHICH INFLUENCE INVESTMENT

The relationship between expansion and contraction of output, on the one hand, and of saving and investment on the other, suggests some further questions such as :—What are the factors which determine the volume of investment ? What are the factors which determine the volume of saving ? What is the mechanism which brings about the postulated equality between saving and investment ?

Let us consider the first of these questions, the question of the factors which determine the volume of investment. Broadly speaking, the answer is that production must be balanced, so that the pattern of production conforms to the pattern of demand. The community needs a certain supply of new houses, of new factories and their equipment and so forth. If the production of these things is inadequate, the community will be badly housed or its production of commodities will be inefficient because its factories and machinery are not up to date. If the production of these things is excessive, the amount of labour which remains available for the production of commodities and services will be less than it could

be, and the standard of living will be affected accordingly.

At any given time and under any given conditions there is a certain rate of production of houses, factories and the like which is calculated to lead to the greatest possible material welfare of the community and which may therefore be regarded as an optimum.

There is also another aspect of the matter. The provision of houses, factories and the like is usually financed by the private investor either directly, or indirectly through the medium of companies or corporations, and the return which the investor will obtain for his money depends on the accuracy with which he has predicted the actual requirements. If the number of houses built is in excess of requirements, rents fall and old houses are left vacant before they have actually ceased to be useful.

Similarly, in regard to factories and equipment, if the rate of replacement is excessive, the proportion of new enterprizes which fail to make good will be unduly high, and the replacement of existing enterprizes will also be excessive, so that an unduly large allowance will have to be made for obsolescence.

It will thus be seen that, at any given time and in any given conditions, there is an optimum rate of investment which is calculated to confer the maximum of advantage to the community and a reasonable return to the investor. To put the matter in slightly different words, *there exist, at any given time and under any given conditions, certain opportunities for worth-while investment, but the total volume of these opportunities for worth-while investment is limited.*

Among the investments which are actually made, the majority are made with the object of making a profit, but investments are also made for other purposes, such as churches, public libraries and so forth, and these investments also come within our definition. The test is whether the investment fulfils the purpose for which it was made.

The chief factors which determine the opportunities for worth-while investment are increases in the size of the population, technical improvements in the methods of production and distribution and the opening up of undeveloped or partially developed territories. Another factor is the rate of interest at which money can be made available for the purpose of investment; there are some investments which are only worth-while when money is obtainable at a low rate of interest.

FACTORS WHICH INFLUENCE SAVING

The two principal sources of saving are saving by private individuals and saving by traders and manufacturers, who retain a portion of their profits either for re-investment in the business or for the accumulation of financial reserves.

Statistical evidence goes to show that the rate of individual saving in any given community is usually remarkably constant. As we shall see in due course, the rate of individual saving in the United States during the whole of the inter-war period was in the neighbourhood of 7 per cent. of total national income. In Great Britain, on the other hand, the rate of individual saving appears to have had a similar value at the beginning of the century, but declined steadily until it reached about 2 per cent. in recent years. This latter result is generally attributed to high death duties and high income tax, which tend to cause dis-saving among those who have the higher incomes.

In neither case does the rate of individual saving appear to have been seriously affected by the great depression or by the boom which preceded it.

The characteristics of business saving, on the other hand, are quite different. Business saving is extremely sensitive to changes in general industrial prosperity, that is to say to changes in national output and national income.

Manufacturing costs are made up in part of certain fixed charges and in part of charges which are proportional to output. There is a certain fixed proportion of total output, perhaps a half or three-quarters, at which business ceases to be profitable. If output falls below this figure the business is operated at a loss instead of at a profit. When a business is working at full capacity profits are usually more than sufficient to give a good return to the shareholder, and it is the practice to hold back a considerable part of these excess profits, which are utilized either for re-investment in the business or for building up financial reserves.

Periods of prosperity are always associated with a high rate of business saving, and periods of depression with low rates of business saving. During the great depression business dis-saving was widespread, and took the form of liquidation or of the sale of assets in order to provide the money necessary to keep the business in existance.

Total saving, which includes both individual saving and business saving, reflects the properties of its two components. Like business saving, it is sensitive to changes in national output; it expands during a boom and contracts during a slump.

THE EQUALIZATION OF SAVING AND INVESTMENT

An individual who saves part of his income may buy government securities, the seller of the government securities may buy industrials, and finally the seller of industrials may invest in some new enterprize, so that we may have a whole chain of transactions with saving at one end and investment at the other. It is necessary to enquire therefore how it comes about that saving and investment are equal, since it is clear that these two different types of transactions may be carried out by two different groups of people acting, to all appearances, quite independently.

There are in fact two different mechanisms at work:—Firstly, if the rate of investment tends to exceed the rate of saving, the rate of interest at which money is offered for investment in new enterprizes rises, and it is found that certain prospective investments are not worth-while. Investment is thus held in check and is compelled to conform to the rate of saving. If the rate of interest is high, then a lowering of the rate of interest increases the opportunities for worth-while investment, so that an increase in saving causes a corresponding increase in investment through the lowering of the rate of interest.

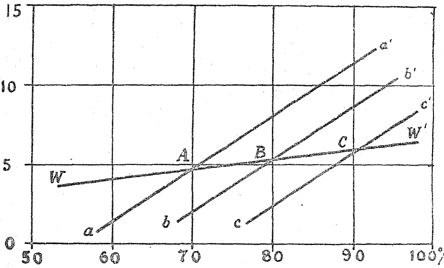
It is found, however, that the lowering of the rate of interest beyond a certain point ceases to be effective; the opportunities for worth-while investment are not unlimited even when the rate of interest is reduced to zero. When saving shows a definite tendency to exceed the opportunities for worth-while investment, the second mechanism becomes operative.

The second mechanism depends upon the fact, already mentioned, that the volume of saving is influenced by the volume of output. This fact enables us to regard saving as a function of output, and the relationship between the two may be called the *propensity to save*. As we shall see in due course, the propensity to save can be determined statistically and can be plotted on a diagram.

There is also another essential fact. If total saving exceeds total voluntary investment, output declines, whereas if total saving is less than total voluntary investment, output rises.

The mechanism at work can now be illustrated by means of a diagram. In Fig. I the line WW' represents worth-while investment. The line aa' represents the propensity to save, cutting the line WW' at A. Then one of two things will happen. If investors are cautious and far-seeing, they will avoid over-investment, and output will settle down at the point marked A in the diagram, indicating that output will be

SAVING *as a percentage of full income*



ACTUAL NATIONAL INCOME

as a percentage of what income would be with full employment

WW′ Value of opportunities for worth-while investment.
aAa′, bBb′, cCc′ Alternative values of the propensity to save.

FIGURE I.

Illustrating the propensity to save.

at 70 per cent. of capacity, with a correspondingly high proportion of unemployment.

If investors are more optimistic and less far-seeing, output may rise to the point marked *a′*, say 90 per cent. of capacity, and it is evident that the opportunities for worth-while investment will then be rapidly exhausted, so that the boom will be followed by a slump, which will carry output down to say 50 per cent. of capacity, the mean value of output over a period of years being 70 per cent. as before.

On the other hand, if the propensity to save is less, say *bb′*, or better still *cc′*, the mean value of output and the mean proportion of employment will be correspondingly higher.

The essential fact is that, whether booms and slumps take place or not, the mean value of saving over a period of years is compelled to adjust itself to a figure which is determined by the opportunities for worth-while investment. Actual output is compelled to conform to this value of saving, that is to say to a figure which is determined by the propensity to save.

This crucial value of output, about which actual output is compelled to fluctuate, is indicated on the diagram by the point at which the line representing the propensity to save crosses the line representing worth-while investment.

A REMEDY FOR LOSS OF PURCHASING POWER

Purchasing power resembles many other beneficial attributes which can be made available for our use. If it is not used to the full it withers and declines.

If the argument in the previous section is sound, and if the assumption that opportunities for worth-while investment are limited is valid, there is only one possible remedy for the loss of purchasing power which is due to over-saving, and for the unemployment which is associated with it : *saving in all its forms must be placed under control, and, in so far as it cannot be controlled, it must be neutralized by deliberate spending.*

CHAPTER VIII

THE EVIDENCE OF OVER-SAVING

OVER-SAVING AND UNEMPLOYMENT IN THE U.S.A.

PROFESSOR HANSEN'S BOOK* gives a diagram showing the consumption function, or the propensity to consume as it is sometimes called, for the period 1921-39, and it is easy to deduce the corresponding propensity to save. The results are plotted in Fig. II. The following figures emerge in the course of the analysis :—

(i) The mean propensity to save, combining both upswing and downswing, is given by the formula $S = \cdot 3Y - 15$, in which S is total saving and Y is total income in billions† of dollars. This gives a multiplier of $3 \cdot 3$.

(ii) Maximum output was reached in 1929 at 83 billion dollars. It may be assumed that this represented 95 per cent. employment.

(iii) The mean value of income (output) over the whole period was 65 billion dollars, representing say 75 per cent. employment.

(iv) National income fell to a minimum in 1932 and 1933, when it amounted to only 38 billion dollars, representing a decline of 55 per cent. from the peak value in 1929. Part of the fall was due to the decline in prices, but the decline in real output appears to have been in the neighbourhood of 45 per cent., and presumably the decline in employment touched a similar figure.

* *Op. Cit.*, p. 236.

† 1 billion = 1000 million.

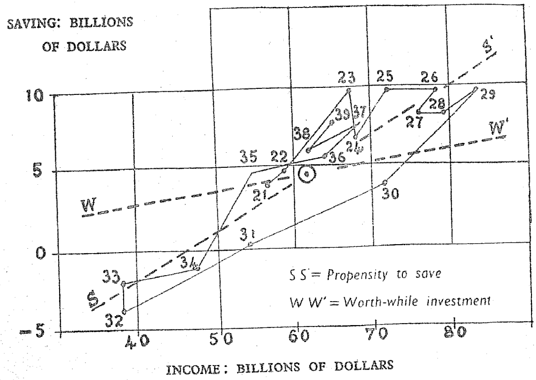


FIGURE II.

Showing Income and Saving in the United States 1921-39.

(v) In 1929 saving amounted to nearly 10 billion dollars, or 12 per cent. of national income. Of this 7 per cent. was due to individual saving.

(vi) The mean value of saving (investment) over the whole period was 4·9 billion dollars, or 7½ per cent. of national income. Of this, 7 per cent. was due to individual saving, which appears to have remained a fairly constant proportion of national income throughout the whole period referred to in the diagram. Business saving only amounted to ½ per cent. on the average; the savings accumulated during the boom were wiped out again during the slump.

There are not sufficient data to determine the precise value of worth-while investment, but the actual mean value of investment is probably a close approximation, and this value, that is to say 7½ per cent., has been plotted on the diagram.

The crucial value of output derived from the above figure and from the equation for the propensity to save is 64 billion dollars, which would correspond to an employment figure of 74 per cent. This point is indicated on the diagram by a ⊚.

It is interesting to note that average income during the four years, 1936-39, averaged 66 billion dollars, agreeing very closely with the above figure and suggesting also that the investor had learned wisdom from previous failures.

The period of nineteen years which is covered by the diagram can be subdivided into four distinct subdivisions :—

(i) The period of expanding output, 1921-29, culminating in the peak of 1929.

(ii) The period of declining output, 1929-32, culminating in the intense depression of 1932-33.

(iii) The period of partial recovery, 1933-36.

(iv) The period of stagnation, 1937-39.

Interpreted in terms of the theory which was developed

in the earlier sections of this chapter, the situation which is revealed by these facts and figures is clear. The period of expansion which began after the first world war, and which reached its peak in 1929, was a period of serious over-saving and serious over-investment. Opportunities for worth-while investment, both at home and abroad, became exhausted, and the subsequent collapse was the inevitable consequence of that lack of balance in the pattern of production. But this is not all. The actual value of business saving in the years 1936-39 was negligible, but its *potential value* was very large. If national income (output) in these years had reached a figure of 110 billion dollars, which it ought to have done, and if the tendency revealed by our diagram can be used for the purpose of extrapolation, which seems to be reasonable, total saving would have approached a figure of 18 billion dollars, of which more than half would have been due to business saving. A corresponding increase of investment to absorb this huge volume of saving would have been entirely out of the question, and, in the absence of any effective means of controlling saving, restriction of output was inevitable.

The factors which influence the course of booms and slumps are many and complex, and the reactions involved are not always easy to follow. In order to obtain a clear view of the situation it is necessary to distinguish between the factor or factors which are of primary importance and those which are only of minor importance or irrelevent. In examining the events which culminated in the great depression in the United States, it becomes increasingly clear that the fundamental causes which lay at the root of the whole business were over-saving and over-investment. This explanation is adequate in itself, and no other explanation appears to be needed.

The period of stagnation in 1937-39, the aftermath of the great depression, also holds its own lesson. By this time the investor had learnt wisdom, and there was no over-investment,

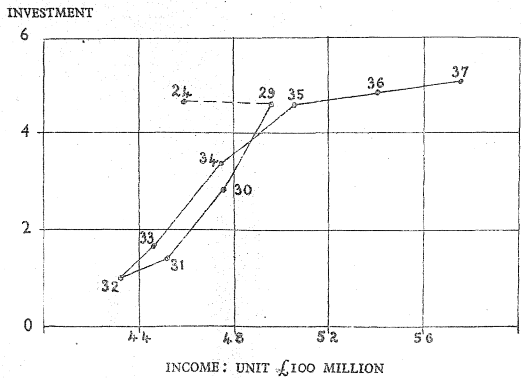


FIGURE III.

Showing Income and Investment in Great Britain 1924-37.

but there was still over-saving, and recovery was halted at a point far short of the point which it should have attained in order to secure the full employment of available resources.

OVER-SAVING AND UNEMPLOYMENT IN GREAT BRITAIN

A diagram showing the relationship between investment and national income in Great Britain during the years 1924-37 is given in Fig. III; the method of preparing the diagram is explained in the appendix (*p.* 150). The following figures emerge in the course of the analysis.

(i) During the years 1924-29 and again during the years 1935-37 there was an expansion of national income amounting in all to 15 per cent., *without any corresponding increase in saving and investment.*

(ii) During the years of the depression, 1930-34, the mean propensity to save is given by the formula
$S = \cdot 55Y - 22\cdot 9$
corresponding to a multiplier of 1·8.

(iii) The mean value of income (output) over the whole period was £M.4823.

(iv) The national income fell to a minimum in 1932. The decline from 1929 to 1932 amounted to about 14 per cent., of which a proportion was due to falling prices. The decline in output was about 10 per cent.

(v) The mean value of investment (saving) over the whole period was £M.370 or 7·7 per cent. Saving was made up as follows: individual saving 3·5 per cent., business saving 2·5 per cent., government saving 1·7 per cent.

(vi) If the five years of the depression are excluded, the mean value of saving and investment for the more prosperous years was 9·6 per cent., of which 4·3 per cent. was business saving.

The average value of the opportunities for worth-while

investment was probably about 6 per cent. of national income.

So far as the great depression was concerned, it is fairly clear that this disturbance did not originate in Great Britain, but was thrust upon the country from without. There is no evidence that over-investment during the more prosperous years was of serious importance. On the other hand, it is clear from the general figures of unemployment during these periods that employment might well have been considerably higher, perhaps 10 per cent. higher, than it actually was.

During the whole period 1924-37 there was a steady and appreciable expansion of national income, but the rate of increase was only 3 per cent. per annum whereas it might well have been 4 or 5 per cent. The lack of elasticity which was displayed by the economic system during this period can only be attributed to an excessive propensity to save.

As regards the items which went to make up total saving, a subdivision of saving under the three heads—government saving, business saving and individual saving—is given in Table II (p. 151). It will be seen that individual saving, particularly in the later years, when it fell to 2 per cent., was not excessive. Government saving was too high; in view of the general tendency towards over-saving, government saving should not have been allowed at all. Business saving was high, although on the average it was not perhaps much too high; but the tendency for business saving to expand with increasing national income (Clark's multiplier) was too high.

A COMPARISON

The analyses of saving in Great Britain and the United States are not only interesting in themselves, but useful lessons can also be learnt by comparing points of resemblance and points of difference.

It will be noticed, for example, that the tendency of business saving towards excessive expansion in times of prosperity was

much the same in both countries. On the other hand the average value of business saving in the United States was lower than in Great Britain, not because the propensity of the American business man to save was less, but because individual saving was higher. National output, as we have seen, is forced down by over-saving, and business saving is forced down by the low level of trade activity. The high rate of individual saving was the fundamental cause of the trouble, and business operations, including business saving, were compelled to conform.

It will also be noted that the rate of individual saving, at 7 per cent. of national income, was much higher than it was in Great Britain, where the figure at the end of the period under discussion fell to as little as 2 per cent. This is a point of very great importance to which we shall return in due course.

A further point is that the depression was far more serious in the United States than in Great Britain. To some extent this may be attributed to the fact that the origin of the disturbance seems to have been located in the United States rather than in Europe, but this can hardly have been the only factor. There is strong evidence that the cumulative factors which tended to amplify and prolong the initial disturbance were much more powerful in the United States than in Great Britain. This aspect of the matter will also receive further consideration when we come to discuss possible remedies.

CHAPTER IX

THE REDUCTION OF UNEMPLOYMENT THROUGH THE CONTROL OF SAVING AND INVESTMENT

STATEMENT OF THE PROBLEM

IT WAS POINTED OUT in the last chapter that over-saving, that is saving which exceeds the amount necessary to finance the opportunities for worth-while investment, must lead inevitably to limitations of output and to unemployment, and that over-saving is in fact one of the primary causes of the periodical depressions with which industrial countries appear to be afflicted, and which have become increasingly conspicuous in recent years.

In the present chapter it is proposed to examine more closely the factors which determine the rate of saving and the rate of investment, and to discuss the measures which might be taken with a view to eliminating or reducing this particular cause of unemployment. Actually, the causes of unemployment are complex, and it will be necessary to make brief references to other factors in the situation in order that over-saving may appear in its correct relationship to the problem of unemployment as a whole.

The particular trouble with which we are immediately concerned is a discrepancy between the volume of saving and the volume of worth-while investment. To ensure full and continuous employment it is necessary that this discrepancy should be removed, or at least that it should be materially reduced.

In embarking upon a discussion of this matter, it is well

to remind ourselves that the problem to be solved is one of considerable difficulty. We are sailing on uncharted seas, and novel courses may be found necessary with very little previous experience to guide us on our voyage. All that can be done is to draw correct conclusions from known facts, so that attention may be directed towards solutions which hold out a reasonable hope of success. The ultimate solution cannot be predicted exactly and may only be reached after a certain amount of trial and error.

Our analysis will begin with a discussion of the problem in its more theoretical aspects, and the solutions which theory suggests will then be illustrated by applying them to certain specific problems which will be examined in greater detail.

There are three types of solution which suggest themselves: the opportunities for worth-while investment might be increased, or the volume of saving might be reduced, or the gap might be bridged by government borrowing.

The first of these alternatives may be dealt with comparatively briefly. There are reasonable grounds for believing that the fluctuations in investment can be reduced by increasing investment during the slump and reducing it during the boom, and this aspect of the matter has already been dealt with in Chapter IV. But the control of the average value of investment is a different matter.

The opportunities for worth-while investment are determined by such factors as the increase of populations and the advance of technical knowledge, and these factors are not amenable to control. It is possible to anticipate future investment needs, but to execute investments in advance of requirements only postpones the trouble, and overcomes present difficulties by laying up still greater trouble for the future. Under the existing system there is no reason to suppose that existing opportunities are neglected, indeed the evidence is all the other way, and it cannot be assumed that the rate

at which opportunities for worth-while investment make their appearance can be substantially increased. Moreover, rapid changes in the character of industrial processes are in themselves a cause of unemployment, and it may reasonably be argued that such changes already take place quite as rapidly as is desirable.

The other two alternatives merit more serious consideration.

INDIVIDUAL SAVING AND ITS CONTROL

During the whole period, 1921–37, individual saving in the United States, expressed as a percentage of national income, appears to have been remarkably constant. The average value was in the neighbourhood of 7 per cent.*

Before the first world war, individual saving in Great Britain was probably of the same order or somewhat larger. As a result of the war, the figure for individual saving fell to 4·8 in 1924 and to 4·5 in 1929. Subsequently, during the great depression, if fell still further and finally reached a figure of 2·1 per cent. in 1937. This decline in individual saving is commonly attributed to the effects of increased taxation, which has led to considerable dis-saving among the higher incomes.

The increase in the national debt which resulted from the war was the cause of increased taxation, which included high death duties on large estates and a steeply graded income tax. Further adjustments were made in later years to meet the cost of social legislation and expenses incurred in connection with the depression.

Death duties are usually paid for by the sale of capital assets, and death duties alone accounted for about £M.85 per annum, or nearly 2 per cent. of the national income. In the case of families which have been accustomed to a par-

* A. H. Hansen, *Loc. cit.*, p. 256.

ticular standard of living for several generations, changes are not readily made, and a reduction in income is apt to be met out of capital, so that a high income tax on large incomes also tends to cause dis-saving. Loss of income on foreign securities and on investments in British railways may also have contributed to the result. Taking all these causes together, the decline in individual saving, amounting to some 5 or 6 per cent. of national income, appears to be adequately accounted for.

The experience of Great Britain in this matter of individual saving is important in that it suggests that individual saving can be reduced by means of an appropriate system of taxation. Heavy death duties and a steeply graded income tax were not introduced into Great Britain for the purpose of reducing the rate of individual saving; nevertheless they have had that effect, and it is reasonable to infer that similar measures would produce similar results elsewhere.

At the same time it must be noted that changes in the system of taxation do not act quickly. The control of individual saving through changes in taxation must be regarded as a long period effect. If a rapid adjustment is needed some other method must be adopted.

BUSINESS SAVING AND ITS CONTROL

The characteristics of business saving have already been referred to in our discussion of the multiplier, and it was then pointed out that conditions which involve a low value of the multiplier during a period of expansion imply that any important increase in the volume of output must involve a serious increase in the volume of business saving. This means one of two things; either investors are optimistic and the result is over-investment, or investors are cautious and the result is restriction of output.

It was pointed out at the same time that what we have

called Clark's multiplier can be regarded as being made up of two factors: firstly, the proportion p of any increment of income which remains in the business after the payment of wages and the cost of materials, and secondly, the proportion q of this increment of gross profit which is retained in the business to be used for investment or for the creation of reserves and not for the payment of dividends.

The first of these factors is related to the fact that modern industrial production is normally subject to the law of increasing returns, and its magnitude, over the short period at least, would not appear to be amenable to control.

In the long run the correct method of avoiding excessive profits is to ensure that any important reduction in cost is reflected in the selling price and is passed on to the consumer, but one of the main difficulties in achieving this object is the disturbing effect of industrial fluctuations. When heavy losses have been incurred during a slump, it is difficult to argue that the shareholder is not entitled to a high rate of profit during a boom. If the amplitude of industrial fluctuations could be reduced, this difficulty would be reduced also.

As regards the question of how excessive profits might actually be brought under control, the problem is far from easy, and it is necessary to postulate a considerable measure of good-will among all those concerned. What suggests itself is that the board of management of every large industrial concern should include a consumers' representative whose duty it would be to see that reductions in cost were duly reflected in the selling price, but the task of such a representative during a period of active expansion would not be an easy one.

The second factor involved in the multiplier is the proportion of the increment of profit which is retained in the business. As regards this factor, it is probably correct to say that the bulk of the money so retained is invested in the business in

one form or another, and it follows that restrictions on business saving are likely to involve also restrictions on the rate of investment. It would thus appear that measures designed for the control of business saving must be considered, not only in relation to their effect on saving, but also in relation to their effect on investment. They are particularly appropriate when it is known that over-investment is actually taking place.

A serious difficulty in the application of any scheme for controlling business saving lies in the difficulty of assessing the proportion of profit which can properly be regarded as available for saving in any particular case. A discussion of this matter would be beyond the scope of the present book, but it may be remarked that the experience gained in connection with the income tax and excess profits duty would certainly be helpful. It might well be found that a scale of saving which would be appropriate in one type of industry would be inappropriate in another.

Such matters would have to be made the subject of special study and would ultimately have to be settled by experience. For the moment all that can be done is to make the point that the existing system of allocating profits operates in a manner which is prejudicial to the interests of the community, and that some method of controlling the excessive business saving which is induced by temporary periods of prosperity is essential to the general welfare.

CUMULATIVE INFLUENCES AND THEIR CONTROL

When output is expanding, the increased output creates additional income or purchasing power, and similarly when output is contracting, there is a reduction of income and a reduction of purchasing power.

A decline in the demand for any commodity compels the manufacturer to reduce his output, workers are discharged and there is a decline in profits. The loss of salaries and wages

causes a decline in the demand for commodities and services in general, and this general decline in demand causes secondary unemployment and so on, so that the initial unemployment is considerably amplified before the situation becomes stabilized.

The decline in profits leads ultimately to a reduction of dividends, but its immediate effect is to cause a shortage of ready money for immediate use in the business. As a result of this shortage of money, investment is suspended and inventories may be reduced more rapidly than is actually warranted by the reduction in output. If the depression is severe, normal repairs and maintenance may be suspended, money may be borrowed from the bank, and weak businesses may be driven into liquidation.

These effects have already been discussed in connection with the theory of the multiplier, and there would appear to be three factors which affect the intensity of a depression and which are at the same time amenable to a certain measure of control. The remedial measures which suggest themselves are :—

(i) Steps to maintain the purchasing power of the unemployed.
(ii) Steps to stimulate or increase investment.
(iii) Steps to prevent dis-investment.

As regards the unemployed, it is clear that, if there were no loss of income, there would be no secondary unemployment due to loss of purchasing power, and the depression would be confined almost entirely to the industries in which it originated. It may therefore be inferred that anything which has the effect of sustaining the purchasing power of the workers must also have the effect of minimizing the general loss of purchasing power and the consequent spread of the depression. It is for this reason that charitable organizations, unemployment pay and poor relief all serve a purpose in mitigating the effects of

a depression, quite apart from the relief which they give to the actual sufferers.

The accepted methods of stimulating investment are a policy of cheap money and a programme of public works. The policy of cheap money needs no further comment. The value of public works may be accepted in principle, but there are certain limitations which have already been discussed.

Dis-investment takes the form of forced liquidation and the postponement of necessary repairs. Financial help to firms which are inherently sound, but are in temporary difficulties is the obvious remedy. The important thing is that the appropriate policy should be decided on in advance, and that, when the emergency actually arises, the necessary steps should be taken with the least possible delay.

GOVERNMENT BORROWING

The characteristic feature of government loans is that they are regarded as investments irrespective of the use to which the money is put.

An excess of saving, over and above what is needed for the financing of worth-while investment, can be reduced by measures designed to reduce the volume of saving or to increase the volume of investment, but it may be found that the results which are attainable by such methods are inadequate. It is also clear that the process of control may be slow in achieving its results, and may therefore be unsuited to the needs of an emergency. Circumstances may arise therefore in which it is necessary to close the gap between saving and worth-while investment by means of government borrowing, and consideration must now be given to the difficulties and dangers of a scheme of this character. It is also necessary to consider how the money should be borrowed and how it should be spent.

Broadly speaking, what suggests itself is that the budget should be divided into three parts :—

(i) The normal budget, which should be balanced.
(ii) The public works budget, which should be financed by borrowing.
(iii) The control budget, whose purpose would be to bring about the necessary adjustment between saving and investment.

The first two parts of the budget are in accordance with normal practice and need no special comment. It is with the control budget that we are immediately concerned.

Assuming that savings are actually in excess of investment, the idea is that a government loan or loans should be permanently "on tap", and would be available to absorb surplus savings as required.

The control budget, which would be adjusted monthly or quarterly, would take account of all government borrowings, including receipts on account of compulsory contributions to social services, on account of the Post Office Savings Bank and on account of government loans for public works. From this total would be deducted the actual expenditure on public works and repayments of government loans, if any, and the balance would be the amount of surplus saving which would require to be neutralized, and which would have to be spent.

It is clear that a scheme of this sort might involve a continual increase in the national debt, and that it might well involve the following dangers :—

(i) The increase in the national debt might lead to an increased burden of taxation and might thereby aggravate the present unequal distribution of wealth.
(ii) There would be a risk that the government might find itself unable to raise enough money in taxation to pay interest on the debt and to repay the loans as they fall due.
(iii) There would be a risk of inflation.

As regards the question of inflation, government borrowing

is of course only one of several possible causes, and the chief danger seems to arise, not in respect of the payment of interest, but in respect of the repayment of the principal. On the other hand, if the suggested loan is to be sufficiently attractive it is essential that there should be facilities for repayment should the lender so desire.

What suggests itself is that loans should be made for a period of (say) 5 years but that normally facilities should be provided for repayment on demand. In case of emergency these facilities could be suspended.

The other two difficulties both boil down to the same thing, the burden of paying interest on the debt out of taxation, and the weight of this burden depends on three factors : the magnitude of the debt, the rate of interest and the general price level. It is well recognized that the rate of interest should be kept as low as possible, but the prospects of reducing the rate below 2½ or 3 per cent. do not appear to be very hopeful. What appears to be needed is some effective method of controlling the price level. If the price level could be given a slightly rising tendency, or could even be prevented from falling, moderate increases in the national debt need not cause any serious anxiety.

GOVERNMENT SPENDING

The idea that a discrepancy between the volume of investment and the volume of saving might be neutralized by government borrowing involves the assumption that the money borrowed by the government will be spent, and various forms of expenditure are possible. In considering these various possibilities, there are certain points to be borne in mind :—

In the first place, the whole plan will defeat its own purpose if the money borrowed by the government is applied to finance investments which would normally be carried out by private enterprise. For our present purpose a mere change

from private management to government management is without significance. In so far as the money can be spent on investments which are of real utility and which would not otherwise be carried out, well and good. When such investments have been provided for, the balance of the money must be spent on consumption, and it must be placed without delay in the hands of people who will really spend it and will not try to save it.

In the second place, the allocation of the money must be carried out in such a way that the expenditure can be rapidly adjusted to meet the changing needs of the situation.

Finally, the allocation of the money must not be made in such a way as to give rise to future claims or create vested interests.

Subject to these conditions the possibilities are :—

(i) The remission of taxation, but this form of spending is open to several objections. Direct taxation should be designed to restrict saving, and it is evidently undesirable that this form of taxation should be reduced at a time when, by hypothesis, saving is in fact excessive. Indirect taxation is usually applied to a limited number of products and is therefore fairly high; constant changes in this form of taxation would create great confusion in the trades and industries concerned. Except to a very limited extent, it would seem that changes in taxation must be ruled out.

(ii) Public works, but the scope of this type of investment is strictly limited, as already explained. Also, it is not easy to make rapid changes in work of this sort.

(iii) Social services. Here there are several possibilities, and it will be sufficient to offer a certain number of suggestions, such as

(*a*) Unemployment pay at normal rates will absorb a certain amount of saving and must be allowed for.

(*b*) Old age pensions might be temporarily increased by the addition of a bonus.

(*c*) Contributions to social services might be temporarily remitted.

(*d*) Special objects of expenditure may suggest themselves in certain cases. For example, money might be spent on the depressed areas as explained in a later section.

THE UNEMPLOYMENT PROBLEM IN GREAT BRITAIN

The ultimate purpose of our present investigation is to furnish guidance for the future, but the conditions which are likely to prevail at some future time are so indefinite that a discussion of future problems would hardly seem to be profitable. It has appeared better, therefore, to consider the problems which have arisen during the past quarter of a century, and to offer suggestions as to what might have been done to avoid the difficulties which were actually encountered.

During the decade immediately preceding the great depression, British trade was hampered, firstly by the return to the gold standard at pre-war parity, and secondly by the flooding of the international markets by American exports financed by means of foreign loans. It has been placed on record by the Macmillan Committee that there was a high proportion of failures among the new enterprizes which were started during this period. These failures can no doubt be attributed in part at least to the difficulties of a period of re-adjustment, but they were also due in part to the special handicaps already mentioned.

Taking everything into consideration, matters were probably no worse than might have been expected. If the monetary

situation had been handled with greater wisdom, the position as regards employment should not have involved any serious cause of complaint.

During the years 1929-32, the years of declining trade, the decrease in output was approximately 15 per cent. as compared with more than 50 per cent. in the United States. The falling off in demand began in the export trades, and everything points to the conclusion that the great depression did not originate in Great Britain, but that the disturbance was thrust upon the country from without. Here again it may be said that Great Britain weathered the storm as well as might be expected.

Great Britain's problems may be said to have really started with the period of recovery which began in 1933. During the five years of recovery, 1933-37, output expanded at the rate of £M.350 or about 7 per cent. per annum, but the recovery was not on a sufficient scale to absorb the whole of the unemployed. It was also noticeable that recovery was confined to certain areas, and that, in other areas, recovery was very far from complete and unemployment was very high. In other words, Great Britain found herself faced with the problem of the depressed areas.

On the matter of saving, individual saving was low at less than 3 per cent., and business saving, at less than 5 per cent., was not unduly high, but total saving was raised to an objectionably high figure by government saving amounting to about £M.100 per annum, or about 2 per cent. of the national income. This depressing influence might well have been avoided; using a multiplier of 3·2, a reduction of £M.100 per annum in government saving would in itself have created an increase of £M.320 per annum in national output, involving the by no means insignificant increase of 6 per cent. in national income.

The suggestion is that the repayment of national and local loans should have been suspended, and that the money should have been spent in restoring to industry the unemployed

workers of the depressed areas. Details of the suggested expenditure were discussed in Chapter V.

At the same time it must be noted that business saving, although not actually excessive, exhibited a tendency to expand with increasing output which could have become of more serious importance if the suggested measures for reducing unemployment in the depressed areas had proved successful. Sooner or later the difficulties created by the existing business practice of retaining and saving a high proportion of every increment in the national income will have to be faced, and some effective check on this form of over-saving will have to be discovered.

THE UNEMPLOYMENT PROBLEM IN THE U.S.A.

It is beyond all reasonable doubt that the period 1921-28 in the United States of America was a period of over-saving and over-investment. There was over-investment in building, over-investment in industrial equipment and over-investment in foreign loans; individual saving at 7 per cent. of national income was excessive, and business saving was of such a character that it absorbed an excessive proportion of increasing profits. It was this over-saving and over-investment during the years of prosperity which must be held responsible for the subsequent collapse.

Let us consider, in general terms, what might have been done in 1921 or 1922 to prevent, or at least to minimize, the subsequent depression. The measures which suggest themselves as having been possible are :—

(i) A system of taxation designed to correct excessive individual saving from the higher incomes.

(ii) The control of business saving with a view to preventing the retention in the business of an excessive proportion of the large profits which are earned during years of prosperity.

(iii) The balancing of imports and exports by reducing restrictions on imports, by discouraging exports, by restricting foreign loans, and by some realistic policy regarding international prices and rates of exchange.

(iv) The introduction of a control budget to neutralize over-saving.

(v) The control of building operations by some system of planning.

(vi) The control of the production of industrial equipment by some system of planning.

Some of these proposed measures are contrary to preconceived ideas, and the author of this book is not prepared to say that they were politically feasible, but it is hardly open to doubt that the adoption of measures of this character would have altered the whole course of events and would have materially reduced the danger of a subsequent collapse.

Let us now turn to the consideration of another question. Postulating the situation which actually existed in 1929, let us ask what might have been done to minimize the intensity of the inevitable depression.

In facing this problem it must be remembered that the depression in the United States exceeded in intensity anything which occurred elsewhere. The reduction in real income (output) was about 45 per cent., as compared with 12 per cent. in Great Britain, and the reduction in money income was 53 per cent., as against 15 per cent. Now the intensity of a depression depends on two factors: the magnitude of the original decline in demand, and the conditions which determine the extent to which the original disturbance is cumulative in its effects. In this connection, a figure given by Colin Clark is of considerable interest.* He states that, during the years

* *The Economist*, September, 1938, p. 440.

1929-33, the share of marginal income going to profit in Great Britain was 0·855, and, as national income was falling during nearly the whole of this period, this means that profits bore the brunt of the fall. In other words, the workers suffered very little loss of purchasing power, and it is reasonable to attribute this result, in part at least, to the existence of an effective organization for the issue of poor relief and unemployment pay. In the United States, on the other hand, the loss of income borne by wages and salaries was probably considerably higher.

In the United States the need for unemployment pay had not previously been seriously felt, and no organization for the purpose was in existence. The original disturbance due to the collapse of investment was no doubt somewhat greater in the United States than in Great Britain, but it would seem, nevertheless, that the intensity of the depression must be attributed in large measure to the cumulative effect of declining purchasing power.

Consider the actual situation in 1929. The period of over-investment had exhausted the opportunities for worth-while investment both in the building trade and in the heavy industries, the export trade was collapsing and inventories had accumulated to an abnormally high level. Obviously a certain decline in output and a good deal of unemployment was inevitable. It was still possible, however, to minimize the loss of purchasing power, to minimize the development of secondary unemployment, to minimize the loss of employment in the industries directly affected and to minimize the reduction in inventories. The measures which suggest themselves were:—

(i) The creation of a proper system of unemployment pay and poor relief.

(ii) A moderate scheme of public works.

(iii) Financial assistance to firms in difficulties, designed to avoid liquidation, to prevent excessive reduction of inventories and to make possible a normal programme of repairs and maintenance.

(iv) Finance would be provided partly by borrowing and partly by the taxation of the higher incomes.

Data are not available on which to base precise estimates, but it is reasonable to suggest that if these measures had been taken, and had been taken in good time, the intensity of the depression might well have been reduced by one half, and the income in the trough of the depression might have been kept to a figure of 55 billion dollars instead of falling to less than 40 billion dollars, the point actually reached in 1932 and 1933.

Finally we come to the question of recovery. The trough of the depression was reached in 1932 and 1933 and output then began to expand again, but it never reached the figure attained in the peak of the boom in 1929, and in 1938 there was a slight recession. The half-hearted character of the recovery may be attributed to the following causes :—

(i) Individual saving at 7 per cent. of the national income was too high.

(ii) Business saving, which was absorbing 46 per cent. of any increment of income, corresponding to a multiplier of 2·2, was absorbing too high a proportion of the increment of income.

(iii) The number of workers in the capital industries was in excess of peace-time requirements.

The appropriate remedies were :—

(i) A system of taxation designed to correct the excessive individual saving, especially from the higher incomes.

(ii) Measures to control excessive business saving.

(iii) The introduction of a control budget to neutralize over-saving.

(iv) A national plan to control the allocation of labour to industry, and to facilitate the transfer of labour from those industries in which it was redundant to those in which it could be usefully employed.

It is reasonable to suggest that these measures would have stimulated recovery and would have prevented any serious check in the expansion of output.

CHAPTER X

INTERNATIONAL FINANCE

THE INTERNATIONAL BALANCE SHEET

In early times the trade between two countries was made up of imports and exports of commodities, and the transactions were settled by payments in gold and silver. In the modern world the actual transactions are of a much more varied character, and the account itself is no longer settled by payments in cash.

Tourist traffic, banking, shipping and similar activities are transactions of an international character, and are included in the account under the heading of invisible imports and invisible exports.

Investors in one country may utilize their savings for the development of industries abroad, or they may lend their money to foreign governments or to foreign individuals, and these transactions must be included.

Finally, debts may fall due on account of interest or sinking fund on loans which were contracted in previous years, and provision must be made for the settlement of these obligations.

The next question to consider is how these transactions are paid for.

THE MEANS OF PAYMENT

There was once a time when individual transactions, both national and international, were settled by payments in gold and silver, but the growth of the banking system involved an important simplification of this rather cumbersome process. As soon as a country's international accounts are collected together in some form of clearing house, claims in respect of imports can be written off against claims in respect of

exports, and it is only necessary to arrange for payment of the balance. This practice is now universal.

During the nineteenth century all the more important countries of the world had provided themselves with gold or silver currencies, and it was natural that any outstanding balance on international account should be settled by the transfer of gold and silver, and this is the system which came into operation and was in actual use for many years. It is commonly described as the gold standard.

For the system to be successful it is necessary that any serious lack of balance, involving transfers of gold and silver, should be temporary, and that there should be some mechanism to restore the necessary balance between imports and exports before the supply of gold in the importing country becomes exhausted. The mechanism by which this result was actually achieved was described in Chapter III.

In recent times an additional means of payment has become available in certain cases in the form of international securities. Great Britain, for example, parted with a large amount of international securities in order to pay for imports during the early part of the war. The case is exceptional, however, for most countries which find themselves in difficulties over their international account do not possess any international securities to sell.

Again, some countries have never balanced their international accounts at all, but have evaded the issue by borrowing. The objection to this practice is that it cannot go on for ever ; sooner or later borrowers expect to be repaid.

In the last resort, a country's international account can only be settled by securing a proper balance between imports and exports, and the crux of the whole matter is the need for some mechanism which will ensure the necessary balance. If the mechanism which formerly operated has broken down, then some new mechanism must be devized.

PANIC MONEY

An investor who can foresee that a particular currency is going to depreciate on the foreign exchanges can secure a handsome profit by transferring his capital abroad before the depreciation takes place. Again, depreciation on the foreign exchanges is often accompanied by inflation at home, and the investor can guard against loss by similar means.

In a world of rapidly varying exchanges there is a strong tendency for capital to move from country to country seeking refuge from the risk of inflation. Needless to say, these flights of capital increase the inherent instability of national currencies and intensify monetary disturbances when they actually take place. It is hardly too much to say that the movements of "panic money" from one country to another have, in several cases, been the initial cause of inflation, and have contributed more than any other factor to the world-wide instability of currencies in general. Indeed, the whole business has assumed so much importance that far more attention has had to be devoted to securing a financial balance in the international accounts than to the real business of developing international trade.

In the case of Great Britain and those countries which are the owners of international securities, the problem created by these flights of capital has been solved by the creation of exchange equalization funds which neutralize the operations of individual speculators, but this remedy is not always available in other cases, and it would seem that the only real remedy is to stabilize the exchanges. In other words we are brought back to the fundamental problem of balancing imports and exports.

INTERNATIONAL INVESTMENT

Savings are more plentiful in highly industrialized communities, and the development of sparsely populated countries

has been largely effected by means of international investment.

A typical case has been the construction of the railway systems in various South American states with money supplied by the British investor. From the trading point of view, the lender country, during the period of expansion, has an excess of exports and the debtor country an excess of imports. From the financial point of view, this difference between imports and exports is balanced by an international loan made by the British investor and secured by the ownership of the railways on the construction of which the money has been spent.

It is obvious that much of this international investment has been beneficial to debtor and creditor alike. On the other hand, it is also clear that many recent developments have been highly detrimental to trade and industry in general, and that the whole system of international investment needs a complete overhaul.

Actually the chief difficulties which have arisen in recent years have been :—

Firstly, the existence of a large volume of international securities, transferable from country to country, has given to individuals the power of moving their capital from one country to another. A large volume of such transactions may unbalance the account, and may deprive a country of the means of paying for its imports.

Secondly, international loans are often made without considering the debtor country's capacity to pay or the creditor country's capacity to receive payment. Ultimately, when the debtor country is compelled to default, it is discovered that the debtor has never paid and had never been able to pay, and that his obligations have only in fact been met by fresh borrowing. The cessation of foreign lending deprives the defaulting country of foreign exchange, compels a drastic reduction of imports and may lead to further default.

Thirdly, indiscriminate national borrowing disguises a country's true position and clogs the economic mechanism which would normally be expected to enforce a balance between imports and exports.

In all cases the upheavals which are the inevitable sequel to any lack of balance cause serious dislocation in trade and industry and involve serious unemployment as the inevitable consequence.

Experience shows clearly that international investment is subject to the same rule as investment in general, that is to say, the opportunities for worth-while investment are limited, and over-investment is inevitably followed by a collapse. To secure the smooth working of international trade some form of control over international investment would appear to be essential.

THE CONTROL OF INTERNATIONAL INVESTMENT

If it is agreed that uncontrolled international investment has been responsible, to a greater or less extent, for the dislocation of international trade, and that some form of control is essential, two questions arise : firstly, towards what objective should the control be directed, and secondly, what means should be adopted for carrying the approved policy into effect.

As regards policy, by far the most important point to realize is that foreign investment must never be regarded merely as an outlet for surplus savings, or as a device for the solution of the unemployment problem at home. It is just as sensible to suggest that unemployment in one of the highly industrialized countries should be cured by exporting surplus goods and surplus savings to another country as it would be to suggest that world-wide unemployment should be cured by the export of surplus goods and surplus savings to Mars or to the Moon.

The only proper way to approach the problem of inter-

national investment is to deal with the matter on its merits, and to insist that judgment must not be warped by fear of unemployment. It is impossible for any nation to view the problem of international trade in its correct perspective when it is haunted by the spectre of unemployment at home.

It follows that the first and most essential step in the restoration of international trade is the elimination of unemployment. When this has been achieved, but not before, international trade and international investment can be dealt with on a rational basis.

As soon as this fundamental difficulty has been removed, the correct attitude towards foreign investment becomes fairly obvious. Loans which are to be utilized for the purchase of capital equipment in the lending country are in the nature of deferred payments, and, subject to normal investigations into the merits of the capital assets which it is proposed to create, are clearly legitimate. Loans which are to be spent on armaments or on consumable goods should be regarded with strong suspicion except in cases of extreme emergency.

If it is considered politically desirable that a foreign country should be supplied with armaments, for which it is unable to pay, it would be much wiser to regard the transaction as a gift.

Unless a country is starving, the making of loans to be spent on consumable goods dislocates international trade, and is purely mischievous to borrower and lender alike. The proper rule in both private and international transactions is for everyone to pay their way as they go.

As regards the question of controlling international investment so as to ensure that it will be carried out in a reasonable way and limited to legitimate objects, the most effective safeguard would seem to be the proper education of the investor. If the ordinary investor, that is to say the investor who has no special knowledge to enable him to pass an independent judgment on the proposition before him, accepts the principle

that his money should only be lent abroad in order to purchase capital assets from his own country, and if he further sees to it that the people to whom he entrusts his money are people of proved experience and integrity, matters cannot go very far wrong. In this matter government departments can be helpful in collecting information and giving advice and assistance.

INTERNATIONAL ACCOUNTING

It is always important in economic matters to find out what is really happening, and it would be a great advantage if all foreign monetary transactions were concentrated in a national clearing house, and if the international balances were finally adjusted through an international clearing union. The formation of an international clearing union appears to be under way, and the matter need not be further discussed here.

In this connection, however, it is necessary to take into account the transfer of international securities from one country to another. Registration of international securities has been widely adopted during the war, and it would be a great advantage if this practice could be adopted permanently.

It is also for consideration whether the right to transfer securities from one country to another is of real benefit to the community as a whole or whether it ought not to be subjected to some form of control.

CHAPTER XI

INTERNATIONAL TRADE

WHY INTERNATIONAL TRADE IS NECESSARY

THE IMPORTANCE OF international trade to the welfare and economic prosperity of a country depends very largely on the size of the country itself. A large country, such as the United States, may include within its boundaries both temperate and sub-tropical climates; it may possess stores of mineral wealth, including such important items as coal and oil; it may possess the factories and equipment which are necessary in order to utilize these resources to the best advantage. A country occupying such a privileged position is free to take part in international trade if it so wishes, but international trade is not indispensable; full employment and a high standard of living are attainable without it.

In the case of small and less favourably situated countries the position is different. Great Britain, for example, is only able to grow a proportion of the food necessary to support her present population, and the balance must be imported. Again, a great variety of raw materials are necessary to maintain what is regarded nowadays as a reasonable standard of living, and these raw materials are not very widely distributed; many countries have to import them.

Large industries are more efficient than small industries, and a small country will have a higher standard of living if it specializes in a small number of large industries and engages in international trade than if it develops a large number of small industries.

In the case of agricultural production, the output which is attainable from a given amount of human effort depends largely on soil and climate and on the suitability of the soil and

climate for the particular crop which it is desired to grow. It may well be that a country can attain a higher standard of living by importing certain agricultural products than by growing them itself.

In these various respects a small country is faced with two distinct types of difficulty. Firstly, it has to import a high proportion of its raw materials and a considerable amount of manufactured goods, and secondly, any industry depending entirely on the home market is unlikely to be large enough to attain a high degree of efficiency. It must be inferred that, if the highest possible standard of living is to be secured, countries should specialize in particular types of production and should enter freely into international trade. The alternative policy of producing entirely for the home market means lower technical efficiency and a correspondingly lower standard of living.

To a large self-contained economic unit international trade, properly handled, can be claimed to possess many advantages. To the smaller states, aspiring to attain a reasonable standard of living, international trade is a vital necessity.

THE PENALTIES OF AN UNBALANCED ACCOUNT

It was pointed out in the previous chapter that a lack of balance in a country's international account can only be adjusted, in the last resort, by restoring the balance between imports and exports.

If a country suffers from an excess of imports, some other country must suffer from an excess of exports, and it may reasonably be argued that there is a mutual responsibility for the condition of disequilibrium. Unfortunately, the penalties for having an unbalanced account are not equally apportioned, under present conditions, between the two offenders.

The exporting country, which in due course becomes the creditor, may lose money in the crash to which disequilibrium

is the inevitable prelude, but it is able to console its investors with righteous talk about the iniquities of defaulting debtors. Its workers are likely to suffer from unemployment, but, while unemployment is regarded as an evil, its causes are imperfectly understood. It is difficult for the creditor country to realize that the collapse may be due to its own lack of judgment, and to the adoption of policies which, while reasonable and legitimate in themselves, may yet involve undesirable consequences.

The importing country, which in due course becomes the debtor, on the other hand, is faced with the hard logic of facts. It must balance its international account somehow, and it is lucky if difficulties in regard to foreign exchange are not accentuated by inflation of the currency.

This condition of affairs has thrown on the debtor countries the full burden of devizing some means of balancing their international accounts, and it is not to be wondered at that the means adopted—the restriction of imports—is open to criticism. It was adopted, not because it is a good method, but because it was the only method which is open to those who were compelled to take action.

The lesson to be learnt from this experience is clear. The responsibility for bringing about a proper balance between imports and exports is not the sole responsibility of the countries which have an excess of imports. It is a joint responsibility which must be shared by all countries alike, irrespective of whether the lack of balance takes the form of an excess of imports or an excess of exports. It is only by mutual co-operation that this problem of balancing imports and exports can be solved in an adequate and satisfactory manner.

THE SMALL COUNTRY AND ITS DIFFICULTIES

A small country, as we have seen, is necessarily compelled to import the bulk of its raw materials and a considerable

proportion of its manufactured goods ; if it is to maintain a reasonable standard of living, it needs a higher proportion of imports than a larger country which is better placed to supply these things from its own resources. It follows that the small country must also in like manner be an exporter, since its imports must be paid for, and it is here that the shoe pinches, for it is more difficult for a small country to develop a similar proportion of exports, and doubly difficult to develop the large proportion of exports which it actually requires.

Actually, a certain number of small countries have solved this problem successfully, but this must not blind us to the fact that it is a matter of considerable difficulty for a small country to develop an adequate volume of exports, and a large number of small countries have failed to discover a satisfactory solution.

In this matter of developing exports from small countries there are two special difficulties to be considered. Firstly, large industries are more efficient than small ones, and the country with the larger home market is therefore able to produce more cheaply. Secondly, the country with an established industry is at a great advantage as compared with a country which is trying to establish new industries for the first time.

It is not altogether surprising that most countries have found that the problem of expanding their exports is insoluble, and that they have been compelled to balance their international accounts by restricting imports. What has actually happened is that one country after another has decided that it was necessary to protect their home industries by tariffs. Great Britain was the last to yield, but eventually she too was compelled to give way, and protective tariffs became universal.

This extensive development of protective tariffs has been widely condemned, but it is necessary to point out that it was not adopted out of sheer perversity. It was adopted for the

simple reason that something had to be done, and that no better method of control appeared to be available. The possibility of developing some better mechanism for the control of international trade will be examined in due course. Meanwhile it must be insisted that the problem does exist and that the solution is by no means obvious.

Actually, the requirements of the small countries are:— Firstly, there must be some adequate mechanism for maintaining a reasonable balance between imports and exports. Secondly, the general condition of trade must be such that properly run industries in the smaller countries must be capable of surviving in the face of international competition. Thirdly, international markets must be made available which will enable every country to sell sufficient exports to pay for necessary imports.

In this connection it is perhaps desirable to emphasize the point that these conditions are a corollary to the section of the Atlantic Charter which provides that every nation is entitled to its share of raw materials. It is useless to state that this right exists if the owners of the raw materials refuse either to give them away for nothing or to accept payment in the only form in which it is possible for other countries to pay.

BALANCING THE ACCOUNT

As we have already seen, a country's international account contains a number of items besides imports and exports, and these items influence the balance, and may, up to a certain point, be used for the purpose of adjustment. In particular, an equalization fund or a deposit with the world bank may be used for settling any temporary lack of balance. A continual balancing of the international account can only be secured, however, by some mechanism which is capable of controlling the flow of imports and exports, and some such mechanism is essential to the working of international trade.

The chief means which are available for the control of imports and exports are :—

(i) The control in detail of all imports and exports by means of import and export licenses.

(ii) Tariffs and subsidies.

(iii) Quotas.

(iv) Changes in the rates of exchange.

(v) Changes in national price levels.

The advantages and disadvantages of these various methods must now be considered.

IMPORT AND EXPORT LICENSES

The control of international trade by means of a system of import and export licenses can undoubtedly be made effective, but it is extremely cumbrous and costly, and involves an unreasonable amount of interference with the normal flow of trade and business.

It seems extremely unlikely that any such system will be seriously considered by the democracies, and it is unnecessary therefore to discuss it further.

FREE TRADE IS NOT A SOLUTION

As we have already seen, it is in the true interest of all countries, and especially the smaller countries, that international trade should expand, but at the same time it is clear that the system of universal tariffs which has actually been adopted and intensified has had precisely the opposite effect. The growth of tariffs has strangled international trade.

Faced with this fact many economists have urged that tariffs should be abandoned by international agreement, and it is necessary that this suggestion should be carefully examined, although it is clear that the existing system of tariffs was not adopted without good reason.

Consider, for example, the development, during the past

thirty or forty years, of the internal combustion engine and the various systems of transportation which are based upon it. Let us ask ourselves what form that development would have assumed in a free trade world. Would motor industries have developed in a number of European countries if they had been faced by free and unrestricted competition from the United States ? Surely not. It seems to be beyond all reasonable doubt that cheap motor cars from the United States would have flooded the European market, and would have destroyed the chances of the smaller and less favourably placed local industries.

Mammoth factories and mass production methods have killed free trade. Some scheme must be devized which will lead to a balanced economy in which small countries can play their part in industrial production.

TARIFFS

In the case of a small country a system of protective tariffs serves a treble purpose : it tends to protect and stimulate home industries, it tends to reduce the volume of imports, and it produces revenue.

There is a definite tendency under modern conditions for large industrial enterprizes to absorb small ones, and for industrial production to become concentrated in the hands of a small number of large and highly industrialized countries. A moderate system of tariffs can be employed to check this tendency and to produce a more uniform distribution of industry, and the use of tariffs for this purpose is certainly justified.

The use of a system of tariffs as an instrument for the control of imports, and thereby as a means of balancing a country's international account, is quite a different proposition. The chief objections to this type of control are :—

(i) It is essentially restrictive in character. The imports

of one country are the exports of another, and a system of control which operates by reducing imports necessarily leads to the reduction of international trade as a whole.

(ii) Theoretically it should be possible for a country which is exporting too much to restore the balance by reducing its tariffs, but this is not possible in practice. Tariffs create vested interests, and the people engaged in any trade or manufacture which is likely to be affected by a reduction will resist any change by every means in their power.

(iii) The system lacks flexibility. The need for detailed discussion of every individual item renders it impossible to make broad and comprehensive changes within a reasonable time.

(iv) In a small country the prosperity of an industry comes to depend on political considerations, or on the whim of the government department which has the control of the tariff system, and this uncertainty is not conducive to efficiency. Manufacturers are tempted to snatch quick profits and have little incentive to build up permanent industries, speculation becomes rampant, and the genuine investor is discouraged.

(v) Efforts by traders and manufacturers to control the tariff in their own interests have a corrupting effect on politics, and the time of the legislature is taken up in discussing the claims of rival groups, while national interests are pushed into the background.

(vi) Tariffs tend to raise prices and add to the difficulties of industries which are trying to manufacture for export.

(vii) Tariffs tend to foster monopolies, and monopolies, unless carefully watched, may promote inefficiency,

and may be conducive to high profits and high wages in privileged occupations, while lowering the standard of living of the community as a whole.

This is a formidable list, and it is all too clear that tariffs have crippled international trade and have led to various undesirable repercussions in the economic structures of the states which have adopted them. This latter aspect of the matter is well described in the following passage* :—

"The benefits of restrictions on specialization and trade accrue, in concentrated form, to relatively small groups in the community, which are, moreover, generally powerful and vocal, and can often command general sympathy by the plea that they compete mainly against foreigners ; the costs of these restrictions are often diffused over broad and unorganized masses of the population, only dimly aware of their own interests in the matter. The efforts of particular interests thus to secure protection for themselves are greatly assisted, in many cases, by the economic ignorance of even some of the most public-spirited statesmen and administrators, whose vague intentions of stimulating national industries are not informed by any principles for discriminating between the efficient and the inefficient. The simple-minded nationalists with positive beliefs that their country should produce some of everything, as a means of asserting full nationhood, have also been of great assistance to determined seekers of privileges at the public expense."

Broadly speaking, a tariff system tends to foster the growth of a large number of small and therefore inefficient industries, whereas what is actually desirable is the growth of a limited number of large and efficient industries capable of holding their own in the markets of the world. It is not suggested that tariffs should be abolished, because, as already mentioned,

* A. J. Brown, *Industrialization and Trade*, p. 13.

they serve a necessary purpose, but what is evidently needed is a moderate system of tariffs, which will give adequate but not excessive protection to national industries, supplemented by some other mechanism which will reinforce and augment the action of tariffs in securing a proper balance between imports and exports.

SUBSIDIES

The difficulty of balancing imports and exports is sometimes met by the payment of a subsidy on exports. These subsidies suffer from the disadvantage that they add to the burden of taxation, and they also have many of the disadvantages of tariffs, so that they are far from satisfactory in practice. They may continue to be employed in special cases, but it is unlikely that they will be adopted to any serious extent.

QUOTAS

The system of granting licenses for imports up to a certain predetermined figure is not an easy one to administer, and it opens the door to abuses and corrupt practices of one kind or another. Home industries are affected by changes in the quota in much the same way as they are by changes in tariffs, and the system is open to similar objections. It is a system which is unlikely to be adopted to any serious extent except in periods of emergency.

VARIABLE EXCHANGES

The simplest method of bringing about a change in the volume of imports and exports is by varying the rate of exchange. If the value of the currency is reduced exports are stimulated and imports are checked, and *vice versa*. Indeed, if nothing particular is done about correcting a lack of balance in the international account, matters are likely to adjust themselves by a sudden fall in the value of some national currency in the international market.

Changes in the rate of exchange are a source of considerable embarrassment to traders, who cannot quote firm prices without risking a loss on the exchange, but this difficulty could be minimized by limiting the change in the rate to (say) ·04 per cent. per week, or 2·1 per cent. per annum.

The fundamental objection to a system of variable exchanges, however, is that it stimulates movements of capital, and that these movements of capital are highly mischievous and tend to make the whole system of international finance unstable.

The possibility that other methods of adjustment may fail, and that changes in the rate of exchange may become inevitable must not be lost sight of, but it seems clear that the objections to a system of variable exchanges are serious and that some better method of control is very much to be desired.

RELATIVE PRICES AND INTERNATIONAL TRADE

If one country is exporting too much and another country is exporting too little, the balance of trade can be restored by raising the price level in the former country and by lowering it in the latter, and this is not a purely theoretical proposition but is well established by experience.

At the time when all purchases both at home and abroad were paid for in gold and silver, the ebb and flow of money brought about changes in relative prices, and any lack of balance between imports and exports was eventually restored through the operation of this automatic mechanism.

Restrictions on the volume of money, or on the volume of credit, have the disadvantage, however, that they cause a decline in the activity of trade as well as a reduction in the general level of prices. The universal adoption of paper money has rendered restrictions on the volume of money and credit unnecessary, and the modern view is that the deliberate restriction of either money or credit is intolerable. If changes in the price level are necessary they must be brought about by other means.

The question of how prices might be controlled will be examined in the next chapter. Meanwhile it must be noted that changes in relative prices, regarded as a mechanism for the control of international trade, have the outstanding advantage that they tend to bring about the necessary balance between imports and exports without either stimulating or restricting the activity of international trade as a whole.

It seems to be clearly indicated therefore that the ideal mechanism for the control of international trade is a moderate system of tariffs supplemented by a system for the control of relative price levels. This ideal system, however, would avoid the indirect control of prices through changes in the volume of money or the volume of credit ; it is necessary that the control over prices should be more direct, and should avoid any interference with, or any restriction of, the activity of trade.

CHAPTER XII

THE PRICE LEVEL AND ITS CONTROL

SIGNIFICANCE OF THE PRICE LEVEL

THE PRICE OF any article is the amount of money for which the article in question can be exchanged in the ordinary course of business, and the general price level may be regarded as a measure of the value of goods in terms of money. Conversely, the reciprocal of the price level is a measure of the value of money in terms of goods.

It was suggested in the previous chapter that the control of the relative price levels in different countries would provide an effective and appropriate means of controlling international trade. Before developing this suggestion in greater detail, however, it is necessary to consider other aspects of the matter, and to examine other reactions which may be involved in changes in national price levels.

DEBTOR AND CREDITOR

A debt is a promise to pay, and the question of how this obligation can be met is a matter which is settled by the law of the land, which establishes the form of currency by means of which debts can be paid. It is evident that changes in the value of the currency, however arising, affect the relative positions of debtor and creditor : a rise in the value of money, that is to say a fall in prices, is to the advantage of the creditor, who can obtain more goods when the debt is paid than he had to forego when the debt was incurred, and *vice versa*.

All modern communities have national and local debts of varying magnitude, and one effect of falling prices is to augment the burden of these debts. It is not in the interest

of the community that the burden of debt, national and individual, should be allowed to increase, and it follows that prices should not be allowed to fall.

On the other hand it is unfair to lenders, who include comparatively poor people who have saved up to provide for sickness and old age, to allow the price level to rise to any very serious extent.

To satisfy both these conditions, changes in the price level should be confined within comparatively narrow limits. It would appear that the ideal is a continually rising price level, the rate of increase being of the order of 1 or 2 per cent. per annum.

POLICY

Taking the various points already referred to into account, it may be said that the ideal price level would fulfil the following requirements :—

(i) Fluctuations would be reduced as far as possible.
(ii) The risk of uncontrolled inflation would be avoided.
(iii) The general trend should be upwards at a rate not exceeding (say) 2 per cent. per annum.
(iv) Relative prices in different countries should be adjusted so as to facilitate international trade by bringing about a balance between imports and exports.

Our next problem is to discover what instrument of control can be made available to put such a policy into effect.

FLUCTUATING PRICES

When trade is expanding, consumption is apt to outrun production and prices tend to rise ; on the other hand, when trade is contracting, output tends to outrun consumption and the tendency of prices is downwards.

It has already been suggested that the intensity of business cycles might be mitigated by suitable methods of control, and

it is clear that, if such control can be made effective, fluctuations in prices will also be reduced.

Apart from this, there appears to be no practicable means of controlling short periods fluctuations in the price level, and they must apparently be accepted as an inevitable factor in the normal operation of the mechanism of supply and demand. Our discussion on the control of the price level is limited therefore to long period effects, and our search for some factor which can be used as an instrument of control will be confined to those which are likely to influence the general trend of prices over a period of years, rather than those which may affect the situation from day to day or from month to month.

THE COSTS OF PRODUCTION AND DISTRIBUTION

When there is a temporary scarcity of any article prices tend to rise, and when there is a surplus prices tend to fall, but these influences are essentially temporary. In the long run the price of any article is closely related to the combined cost of production and distribution, and our problem of controlling the price level resolves itself, therefore, into the problem of controlling these costs. The three chief factors which determine the costs of production and distribution are :—

(i) Technical efficiency.
(ii) Salaries and wages.
(iii) The cost of capital, commonly described as profit.

A business may be owned and managed by the same individual, and in that case there may be no clear dividing line between the cost of management and the cost of capital, but, for our present purpose, it is convenient to regard these two items as distinct.

The question of technical efficiency need not detain us : it should be made as high as possible, but the rate of change is actually small. Experience shows that in the more progressive

countries the increase in technical efficiency is of the order of 3 per cent. per annum, that is to say, if wages and profits remain constant, the price level may be expected to decline at the rate of about 3 per cent. per annum.

WAGES AND PRICES

If the costs of any business are examined, it will be found, in the vast majority of cases, that the chief item of expenditure consists of wages and salaries. Moreover, if the question of capital cost is considered, it will be found that wages also enter into the costs of capital equipment and have an indirect effect on the cost of capital.

Without suggesting that there is complete harmony between wages and costs, it is nevertheless true that the general level of wages and salaries is by far the most important factor in determining the costs of production and distribution. This fundamental fact assumes great importance when we come to consider the question of control.

PROFIT

The chief items of cost which are involved in the supply and maintenance of capital equipment and which are met out of profits are :—

(i) Replacements of items which are worn out.
(ii) Provision for obsolence.
(iii) Interest.

So far as normal repairs and maintenance are concerned, the cost falls into the same category as the materials which are consumed in the course of production, and the expenditure should be dealt with accordingly. When particular items possess a greater measure of durability, and are not replaced at such regular intervals that they can be represented by a constant charge in the annual accounts, they may be made the subject of a special item in the balance sheet under the heading

of depreciation. If it is estimated that a particular machine will wear out in twenty years, for example, then a sufficient sum must be set aside annually to cover the cost of a new machine when the original machine wears out.

The question of obsolescence presents a much more difficult problem. The development of some new process may render a whole industry obsolete, and such a contingency cannot be foreseen and cannot therefore be covered by any normal method of accounting.

Again, when some new enterprize is under discussion, it is impossible to foresee with certainty whether it will succeed or not, and in fact many new enterprizes fail to establish themselves.

From the investor's point of view, if he is to continue to provide money for industrial undertakings, the earnings on those enterprizes which are able to pay dividends must be sufficient to cover, not only the normal interest on the capital involved, but also the losses which are incurred in respect of new enterprizes which fail to make good and of established enterprizes which are driven out of existence. These points must be borne in mind when trying to decide whether the profits which are being made in any particular enterprize are excessive or otherwise.

From the statistical point of view the problem of deciding whether industrial profits are actually excessive or otherwise is an extremely difficult one, for the statistical information regarding well established and successful enterprizes is naturally more complete than it is in regard to enterprizes which have been unsuccessful. From such information as is available, however, the author would venture the opinion that, if due allowances are made for failures of one kind or another, the yield on industrial investments in Great Britain and the United States in recent years has not been higher than the normal rate of interest on gilt-edged securities. However, this is not the only aspect of the problem.

In our study of the effects of over-saving it was pointed out that expanding trade is commonly associated with an excessive increase in profits and a correspondingly excessive increase in business saving. This is a very serious matter, and, if full employment is to be maintained, it is essential that these excessive profits and excessive savings should be prevented. Unfortunately, the problem is far from easy.

A further difficulty presents itself in the case of small countries which are compelled to protect their industries by high tariffs. Owing to the small market, industrial monopolies are almost inevitable, and even then many factories are too small to be reasonably efficient. There are three conditions to be fulfilled in providing for the proper economic working of national industries, and a statement of these conditions is sufficient to disclose the difficulty of the problem which we are called upon to solve. Firstly, the industry requires sufficient protection to enable it to operate in the face of foreign competition; secondly, the industry must be influenced in some way so as to ensure that it is operated at a reasonable degree of efficiency; and thirdly, the industry must be allowed to make a sufficient profit, but must be prevented from taking advantage of its monopoly to make a profit which can be regarded as excessive.

THE CONTROL OF PROFITS

Under competitive conditions, the individual trader or manufacturer is prevented from making excessive profits by the purchaser's natural inclination to buy in the cheapest market. In the distributive trades competition appears to be real and effective. In other cases there is a strong tendency towards the development of monopolies, and, under modern conditions, this tendency is accentuated by the increased efficiency of the larger factories and seems likely to increase.

The problem is difficult, and conditions vary widely in different countries, so that it is impossible to suggest any

general remedy. Broadly speaking, however, it has come to be recognized that the management of industry is not a matter which is solely the concern of the owners of the factories and equipment. The workers and the community as a whole are both interested in the decisions of the management, and should be allowed some voice in framing the policy which is being pursued.

It has been suggested, for example, that the management of all public utilities and all important industries should be placed in the hands of public boards, and presumably the members of these boards, or at least a proportion of them, would be elected by the government. The introduction of this political element into industry is somewhat suggestive of totalitarian methods and does not appear to be free from objection.

Again, it has been suggested that boards of management should include representatives of the workers and representatives of the consumers. The question of workers' representatives presents no theoretical difficulty, and appears to be mainly a question of mutual goodwill. The question of the consumers' representatives is more difficult, and it would be necessary that their duties should be clearly defined. What suggests itself is that they should be given the duty of expressing an opinion as to whether profits are reasonable and as to whether the allocations to reserve are necessary, or whether prices should be lowered. A corps of chartered accountants would appear to be a suitable body to carry out such duties.

In the case of industries which are given the support of protective tariffs, a periodical study of the position, including a comparison between the efficiency of production at home and abroad, would seem to be indicated. High profits might suggest the advisability of lowering the tariff.

The merits of any particular scheme must evidently depend on the conditions prevailing in the country concerned, and

no useful purpose can be served by dealing with the matter in greater detail in our present investigation.

THE CONTROL OF PRICES

The direct control of prices is convenient in certain cases, such as public transport systems, but experience shows that the direct control of the prices of commodities and services generally is not practicable. If control of the price level is to be successful other means must be adopted. It was pointed out in an earlier section that the most important factor in determining the general level of prices is the rate of wages, and what naturally suggests itself is that control of the general level of wages should be accepted as a recognized method of controlling the price level.

In actual fact the control of foreign trade under the gold standard operated indirectly through changes in the rate of wages, but the mechanism operated with difficulty and ultimately failed, chiefly because it was necessary on occasions that wages should be reduced. It must be accepted therefore, as the result of this experience, that a scheme for the control of wages must be based on the assumption that wages must always be adjusted upwards and never downwards. There appears to be no reason, however, why this condition should not be complied with, a point which will be dealt with in greater detail in the next chapter.

The proposal is therefore that the general level of wages should be utilized as an instrument for the control of the price level, and that the control should aim :—Firstly, at giving the general level of prices an upward trend of the order of 1 or 2 per cent. per annum, and secondly, at adjusting relative price levels in different countries in such a way as to equalize imports and exports.

In practice this would mean that the more progressive industrial countries, and particularly the United States, would

raise the general national level of wages at an agreed rate of between 4 and 6 per cent. per annum, and that other countries would review their national rates of wages annually, and would raise them at a rate not exceeding 6 per cent. per annum, the exact amount depending on their balance of trade.

CHAPTER XIII

A WAGES POLICY

EXISTING METHODS

THE EXISTING METHOD of dealing with disputes regarding wages is to leave the matter to be settled by a process of direct bargaining between employer and employed, and this procedure is based on the doctrine that every individual has the right to do what he likes with his own, and that every worker has the right to decide for himself whether he is prepared to work or whether he will refuse to work.

In connection with this doctrine of individual rights, however, it is necessary to bear in mind that everyone in the modern world lives in close contact with his neighbours, and that no-one, from the richest to the poorest, is in a position to provide himself with the means of subsistence without the assistance of others.

In the case of the employer, a decision to increase or reduce output, or a decision to close some particular factory, is not a matter in which the management and the owners of the factory are solely concerned. Such decisions affect the workers, to whom the factory represents a means of livelihood, and they affect the community generally, who have need of the products of industry. Unless the rights of the employer are exercised in a reasonable manner, the community may decide that the system is intolerable and that it needs amendment.

In the case of the worker, the right to refuse to work may be exercised in such a way as to cause intolerable inconvenience to the community as a whole, or alternatively the inconvenience caused by a refusal to work may be trifling, so that there may be wide differences in the bargaining power of different groups of

workers. The result is that the workers who earn the highest wages are not those who are the most skilled nor the most deserving, but simply those who have the highest nuisance value. It has long been recognized, for example, that wages in the sheltered trades, that is to say in trades which are not exposed to foreign competition, are generally higher than wages in those trades which, from the nature of their work, are compelled to compete in international markets.

It must also be recognized that the idea of individual freedom, which is supposed to provide the justification for the existing practice, has only a theoretical existence. In actual fact the wages of the individual worker are not settled by the worker himself; they are settled by his trades union, and the worker has no choice but to accept what is settled on his behalf.

A further objection to the existing system is that it is entirely unjust to the farmer, who, being in the nature of things an individualist, is at a disadvantage in competing against the industrial worker for a reasonable share of the national income.

It is therefore clear that the existing method of settling wages by means of separate bargains between employers and workers in each individual industry is neither sound in principle nor equitable in practice, and there are good reasons for seeking to devize something better.

DIFFICULTIES OF THE EXISTING SYSTEM

Most countries are provided with some sort of machinery for the settlement of industrial disputes, but it is one of the outstanding difficulties of the whole business that there are no clearly defined principles on which such bodies can base their decisions. It is the universal practice for the workers to demand higher wages and for the employers to resist these demands, and the main function of the tribunals is to try to discover

some compromise which both sides are prepared to accept.

As regards the employers, their degree of resistance depends largely on whether they believe that they can eventually safeguard their own position by passing on the increased cost to the public in the form of higher prices, and it is clear that, in this type of bargaining, the workers in the sheltered trades are always at an advantage as compared with others.

It is also clear that the repercussions on the interests of the community in general, which are certain to be involved in the decisions, are unlikely to receive any consideration whatever.

WAGES AND THE COST OF LIVING

At first sight, it would appear that an increase in the cost of living justifies a corresponding increase in the general rate of wages, but propositions of this sort require critical study before they can be accepted, and in particular they need to be examined in the light of experience.

The fact is that the national income, measured in terms of goods and services, is determined by national output and is not increased by increases in money wages. Experience shows that increases in wages are normally followed by corresponding increases in prices, and that attempts to adjust wages to the cost of living only lead to a continuous process of inflation or deflation as the case may be.

In the interest of monetary stability, that is to say stability of prices and stability of the currency, any attempt to adjust the level of wages to conform to fluctuations in the cost of living is fatal. Only the most extreme demands of political expediency can justify any compromise in this direction.

The question of local wages is, of course, a different matter. If it can be shown that the cost of living in certain parts of the country is higher than elsewhere, then it would be quite reasonable to suggest that local wages should be adjusted accordingly ; but that is another story.

A NEW MECHANISM FOR THE ADJUSTMENT OF WAGES

In seeking for a new and better mechanism for the adjustment of wages, it is clear that first consideration should be given to the interests of the community as a whole, a matter which is actually of paramount importance, but which has not hitherto received the attention which it deserves. To meet this requirement it is necessary that the process of adjustment should be dealt with in two stages.

In the first place, a decision is necessary as to whether the general level of wages throughout the country should be raised or lowered, and if so, in what proportion. Responsibility for this decision would presumably rest with the government, which would be guided by a small expert committee on which employers and workers would be represented. The main consideration would be the need for securing a balance between imports and exports. The position would be reviewed annually.

In the second place, a wages tribunal would be needed in order to deal with applications for preferential treatment from individual trades and industries. No doubt, existing machinery could be adapted for the purpose. Probably the most convenient procedure would be to consider first all applications for preferential treatment, and then to fix a basic rate which would apply to all other occupations. Assume, for example, that the general rate of increase is fixed at 4 per cent. for the year; assume that the tribunal decides to grant a 10 per cent. increase in occupations covering 10 per cent. of the total; then the basic increase for the remaining 90 per cent. would be 3·3 per cent.

It may not appear at first sight that this new procedure differs materially from the arrangements already in existence, but there is the fundamental difference that the business of fixing wages would no longer be dominated by the idea that it is in the interest of the workers that wages should be raised and that it is in the interest of the employers that they should

be kept as low as possible. Emphasis would rather be laid on the much more important consideration that the earnings in any particular occupation should be fixed on the basis of a comparison with the earnings in other occupations in the same community.

This method of approach does not, of course, exclude the possibility that consideration might be given to differences in the cost of living in different localities, to differences in skill or to other considerations of a similar character. Such factors may be taken into account if considered desirable.

THE TREND OF WAGES SHOULD BE UPWARDS

The idea that increases in wages are to the advantage of the worker is not likely to die easily, and it is fortunate that our general argument in regard to policy leads definitely to the conclusion that the trend of wages should be upwards. There are two factors to be considered.

Firstly, there is the question of the price level itself, in regard to which it has been pointed out that the trend should be upwards at the rate of 1 or 2 per cent. per annum.

Secondly, account must be taken of the increasing efficiency of production; in progressive countries 3 per cent. per annum is a usual figure.

A rise in the general level of wages at the rate of about 4 or 5 per cent. per annum would therefore be quite in order, and may be taken as the ideal trend in a progressive world economy; and it will thus be seen that the principle that the trend of wages should be upwards may be accepted without restricting the usefulness of wage control as an instrument for the control of prices. The margin of adjustment between holding wages constant, on the one hand, and raising them at a rate not exceeding 6 per cent. per annum, on the other, would appear to give all the flexibility which is necessary, in normal circumstances, for an adequate control of the price level.

In this connection it is interesting to note that, in the British proposals for an international clearing union*, the suggestion is made that, in countries which have excessive international credit balances, wages (money rates of earnings) should be increased, but there is no corresponding suggestion that, in countries which have excessive debtor balances, wages should be reduced.

THE COMPOSITION AND POWERS OF THE WAGES TRIBUNAL

The simplification of the issues on which the wages tribunal would be called upon to adjudicate should greatly facilitate the task of arriving at decisions, and there is no reason to suppose that the questions raised could not be dealt with successfully by any representative body of employers and employed.

It is reasonable to hope that the decisions given would be much more readily accepted under the new system than they have been in the past, and that they would be enforced by the pressure of public opinion rather than by the threat of legal proceedings.

THE WAGES SCHEME IN ACTION

The suggested procedure for fixing wages arose out of the idea that an instrument is needed for the control of the national price level, and the scheme was advocated because it appeared to provide the correct solution to that particular problem. If the scheme is examined in its more general implications, however, it will be found that it possesses many advantages extending beyond the particular field of application for which it was originally proposed. Some of the advantages which may be claimed for the scheme include the following :—

(i) It provides an effective instrument for the control of world prices which can be utilized in such a way as

* *Proposals for an International Clearing Union*, published by H. M. Stationery Office, pp. 8 and 9.

to provide a reasonable compromise between the claims of debtor and creditor respectively.

(ii) It provides an effective instrument for the control of relative prices in different countries and thus for controlling the balance of trade.

(iii) By securing a balance between imports and exports it eliminates a serious cause of unemployment.

(iv) By assisting in the elimination of unemployment it would secure a higher standard of real wages than would otherwise be possible.

(v) Owing to the simplification of the issues it should go far towards removing the existing causes of trade disputes.

(vi) As soon as the principle of having a settled policy in regard to wages comes to be generally recognized and accepted, the danger of inflation will largely disappear.

(vii) The scheme provides the only workable method of reducing the burden of national debt. In an era in which over-saving is all too prevalent the repayment of the debt out of taxation is no longer admissable.

A scheme which holds out such high hopes of removing outstanding difficulties in the economic system is surely worthy of being given a trial.

CHAPTER XIV

AGRICULTURAL PROBLEMS

AGRICULTURE AND INDUSTRY

THE PROBLEM OF unemployment is very largely an industrial problem—a problem of the towns rather than of the country—but the smooth working of the economic machine depends on the smooth working of its component parts, and agricultural difficulties involve reactions which cannot be ignored.

Agricultural problems are complex, and they vary widely in different countries, and no general solution is possible. Our discussion of the matter is necessarily limited therefore to a few observations of a very general character.

Broadly speaking, agricultural problems appear to fall into four main groups.

Firstly, the introduction of machinery has made possible the maintenance of existing output with much less human effort, and the proportion of the total population which can be usefully employed on the land has declined. At the same time the development of motor transport and other technical advances has reduced the demand for agricultural products.

Secondly, for various reasons which will be set out in due course, the earnings of the farmer tend to be lower than the earnings of the industrial workers in the towns.

Thirdly, agricultural output is liable to fluctuations due to the weather and other causes, while international demand is liable to the fluctuations which are associated with highly competitive conditions, and both types of fluctuation become reflected in intense fluctuations in prices, and consequently in the farmer's earnings. These fluctuations in agricultural earnings and purchasing power react on industry and may be

the cause of considerable unemployment.

Fourthly, the efficiency of agricultural production is higher in the newer and less densely populated countries, and the competition from these countries tends to make the cultivation of land in some of the older countries unprofitable.

We must now consider how far it is practicable to alleviate these various disabilities.

THE FLIGHT FROM THE LAND

Insofar as machinery has reduced the amount of labour which is necessary in order to cultivate a given area of land, and bearing in mind that such changes tend to improve the standard of living, it is clear that the movement of population from the country into the towns is desirable, and indeed inevitable. The difficulty is that in some cases it appears to be going too far.

In some of the older countries, partly owing to the use of unsuitable methods of cultivation, partly owing to less favourable conditions of soil and climate and partly owing to the greater density of the agricultural population, the efficiency of agricultural production is lower than it is in the newer and less densely populated countries. The result has been that agriculture in the older countries has become unprofitable, and there has been a definite tendency for the land to be abandoned and to pass out of cultivation.

If this condition of affairs is to be remedied, and if the flight from the land is to be kept under control, it is evidently necessary that matters should be so arranged that the standard of living of the workers on the land should not be appreciably lower than that of their fellow workers in industry, and also that the return on capital invested in the land should compare favourably with the return on capital invested elsewhere.

In order to keep the land in cultivation, it has been found necessary in many European countries to protect and subsi-

dize the farmer in one way or another. Provided that the methods of cultivation actually adopted do not tend to destroy the fertility of the soil, this policy seems to be reasonable enough. Its application to a highly industrialized country such as Great Britain, in which the agricultural population is less than 10 per cent. of the total, presents no particular difficulty.

When an attempt is made to apply the same principle to a conglomeration of small states, the problem is much less easy, for each individual state desires to buy in the cheapest market and is unwilling to adopt a policy which can be interpreted as a free gift to its neighbours. We shall return to this problem in a later section.

LOW EARNINGS

Agricultural problems vary widely in different countries, but there is one very general and widespread complaint: that the farmer's life is harder and that his earnings are lower than those of the industrial workers in the towns. This condition of affairs may be ascribed to a variety of causes :—

(i) The farmer is essentially an individualist, and he is therefore at a disadvantage in comparison with industrial workers, who are able to combine together and thereby acquire increased bargaining power in their demands for higher wages.

(ii) The market for agricultural products is essentially inelastic, and any surplus production exercises an abnormal influence in depressing prices.

(iii) Quite apart from lack of organization and the difficulty of exercising any form of control, agricultural output is dependent on the weather and is not easily adjusted to changes in demand.

(iv) In recent years the demand for agricultural products has tended to decline, firstly owing to the introduction of motor transport in place of horses, and secondly

owing to the introduction of artificial fibres in place of the natural products.

(v) In the more densely populated countries farms are small and the efficiency of the individual farmer is low, so that the cost of production is higher than it is abroad. This difficulty may be further accentuated if the type of output which is demanded is not that for which soil and climate are the most suitable.

In countries which do not produce the whole of their agricultural requirements, and which are therefore importers of foodstuffs, this question of keeping up the farmer's standard of living can be solved by means of tariffs, subsidies and marketing organizations in whatever manner may be found to be expedient, and over-production can never become a serious difficulty. In countries which are exporters of agricultural products, on the other hand, the problem is much more difficult, for too liberal a measure of assistance to the farmer may lead to over-production. The only thing which can be said is that there does appear to be a definite need for national planning and control, which must aim at securing adequate production and a reasonable standard of living for the farmer, but must avoid over-production or must be prepared with schemes for absorbing the surplus products.

FLUCTUATIONS IN OUTPUT

Fluctuations in industrial production are mainly due to fluctuations in demand, but agricultural fluctuations are mainly due to the influence of the weather and to the effects of international competition.

The problem to be solved is two-fold. Firstly, it is necessary to store the surplus production of the good years to make up the deficiencies of the lean years, and secondly, it is desirable that the farmer's earnings from year to year should be equalized as far as possible.

As regards the second point, the ideal would be that the price paid for any crop should vary inversely as the national output, so that the average earnings of the farmers throughout the country should remain substantially constant from year to year. Actually prices usually vary more widely than this, with the result that the larger the crop the less do the farmers receive for it. What seems to be required is that purchasing and storage should be in the hands of a national board with powers to fix prices in accordance with the above principle. It is also beyond question that a certain measure of international planning would be beneficial, if such an arrangement would be politically feasible.

AGRICULTURE IN EUROPE

Europe is not unfavourably placed in respect of the development of industry, but the higher density of the population places European countries at a disadvantage in respect of many branches of agriculture. Also there are many agricultural products for which soil and climate are unsuitable. A century ago wheat was perhaps the only really important agricultural product which could be transported for long distances, but this is no longer true today. Meat, butter, eggs, milk, to name only a few items, can now be conveyed safely from the most distant parts of the globe. The result is that the farmer is no longer protected by the inherent difficulties of transport, and he must compete as best he can with other producers who are much more favourably situated. The problem was solved for a time by switching production to those types of product for which transport was still difficult, but this expedient is becoming less and less effective, and many European farmers have been driven out of business.

Faced with the threat that a great deal of land capable of being used for agricultural purposes of one sort or another would become derelict, Great Britain, France, and many other

countries definitely adopted the policy of protecting and subsidizing their farmers to keep the land from going out of cultivation.

In the case of a highly industrialized country like Great Britain, in which the agricultural population is less than 10 per cent. of the total, this solution of the problem presents no serious difficulty, but in the case of smaller and less highly industrialized countries, which are compelled to pay for their imports by means of agricultural exports, the position is much more difficult.

If they are to achieve a reasonable standard of living, these small agricultural countries must receive some sort of support from their more highly industrialized neighbours, but it would hardly be possible to attain this end by direct negotiations between the countries concerned. Nor does it seem likely that local customs unions formed by groups of small states would possess any large measure of political stability.

It would rather seem as if a customs union embracing the whole of Europe except Russia would have a greater chance of success. It would not, of course, be possible to arrange for free trade within the union, but the union might be expected nevertheless to serve two useful purposes. Firstly, it might use its influence to moderate the intensity of particular tariffs. Secondly, it might impose a scale of minimum tariffs which would be applicable all along the seaboard. Such a tariff would provide the necessary protection in the form required while at the same time distributing the burden as widely as possible.

Perhaps the chief merit of a European customs union would be that it would bring the various countries together for the discussion of the tariff problem in its most general aspects, and would enable the more peaceful powers to exercise some restraint over their more quarrelsome neighbours.

CHAPTER XV

SUMMARY AND CONCLUSION

A SUMMARY

THE RESULTS OF our investigation may now be briefly summarized. There appear to be four serious types of unemployment to be dealt with.

Firstly, unemployment is caused by fluctuations in the demand for industrial equipment and in the demand for buildings. The remedy is a certain measure of national planning and a certain measure of control over the volume of output. The control, in part at least, might be voluntary, and might be assisted and supplemented by an appropriate control of government expenditure.

Secondly, unemployment is caused by the decline of existing industries owing to the development of new industries of greater technical efficiency. The remedy is to facilitate the transfer of the displaced workers to other occupations. The scheme would include the cost of training and the payment of wages or part wages during the period of transition. It would also be necessary to co-ordinate this business of transfer with plans for the development of housing and plans for the expansion and location of new industries.

Thirdly, unemployment is caused by the decline in purchasing power which arises from over-saving. Our diagnosis of the causes responsible for this type of unemployment and the proposals made for dealing with it are summarized in the next section.

Fourthly, unemployment is caused, especially in the smaller countries, by the competition of larger and more efficient industries abroad. This aspect of the unemployment

problem raises the whole question of international trade, and our proposals for dealing with this problem are also summarized in a later section.

In addition to these matters, which relate more particularly to industrial employment in the towns, the business of agriculture presents a variety of problems, which involve repercussions in various directions, and which will need to be dealt with. Measures which suggest themselves for consideration are: schemes for sustaining agricultural prices by increasing the bargaining power of the farmer in the marketing of his produce, national schemes for storing the surplus output of exceptionally good years, and a certain measure of international planning in respect of international purchases of agricultural products.

OVER-SAVING AND ITS CONTROL

The true significance of over-saving and its influence in the creation of unemployment have not hitherto been sufficiently understood or sufficiently appreciated; and yet the point at issue is neither very obscure nor very difficult.

Whenever productive work is in hand two distinct effects are produced. Firstly, goods and services are created which in due course become available for use. Secondly, purchasing power or income is created which in due course becomes available for the purchase of the goods and services which have been produced. Eventually the stream of purchasing power meets the stream of goods and services and the latter find their way into the hands of the people who are going to use or consume them.

It is at this point that trouble arises. Expenditure is not necessarily exactly equal to income. If the community as a whole spends more than its income, stocks of goods decline and output is stimulated; on the other hand, if expenditure is less than income, stocks of goods increase, output declines

and unemployment increases. The same principle may be expressed by saying that when investment exceeds saving output expands; and when saving exceeds investment output contracts.

It has been suggested that the opportunities for investment are unlimited, but experience does not confirm this view. The opportunities for worth-while investment are limited and appear to amount, both in Great Britain and in the United States, to about 7 per cent. of national income.

Actually, saving in the United States in the years 1925-29 was about 12 per cent. of national income, with the result that the opportunities for worth-while investment were exhausted, investment declined, and purchasing power collapsed.

The only possible remedy for this state of affairs is the control of saving, which is of three main types. Individual saving should not exceed 3 per cent. of national income, and there is evidence that it can be kept down to this figure by a suitable system of taxation and death duties. The trouble with business saving is not so much that it has actually been excessive in recent years, but rather that it tends to increase with undesirable rapidity when trade expands. It acts as a brake on expansion and the attainment of full employment is thereby prevented. The remedy is that the reduced costs which are associated with expanding output must be passed on to the consumer in the form of reduced prices, and must not be used, except to a moderate extent, to increase profits out of which funds are obtained to build up increased financial reserves. To meet this requirement it is suggested that the boards of management of all large business enterprises should include representatives of workers and consumers, whose duty it would be to see that reduced costs are dealt with in conformity with these principles.

The volume of government saving should be determined by the opportunities for utilizing the money in worth-while

investment, and not by considerations of financial orthodoxy. If other means of controlling the volume of saving prove to be inadequate, the government should borrow the surplus savings and should spend them. The aim being increased consumption, expenditure should be on social services rather than on public works.

THE UNEMPLOYMENT PROBLEM IN THE U.S.A.

In the earlier years of the two great world wars the forces of Great Britain were in the front line, and the forces of the United States were in reserve. In the struggle against unemployment the position will be reversed, and the citizens of the United States will find themselves in the front line.

Throughout Europe at least, all available savings will be needed, for a decade or more, in order to make good the destruction caused by the war, and over-saving will hardly be possible. No similar wave of destruction has swept over the United States, and that country will be faced, as soon as peace is established, with the problem with which it was faced and failed to solve in 1919.

The great depression of 1932-33 and the partial failure of the subsequent recovery were alike caused by a loss of purchasing power due to over-saving, and it is of fundamental importance, both to the United States and to the world at large, that such a catastrophe should not be repeated. The problem is essentially one which must be faced and solved by the citizens of the United States, but the progress of the struggle will be watched with breathless interest by the citizens of every country in the world.

The lessons to be learnt from this struggle against unemployment in the United States will be of extreme importance to other industrial countries which are likely to be faced in due course by similar problems, but the matter does not end there. No country can possibly adopt a reasonable attitude

towards international trade so long as it is haunted by the spectre of unemployment at home. The restoration and expansion of international trade depend on the elimination of unemployment in the United States, and by far the most important contribution which can be made by the United States to the cause of universal peace and prosperity is the solution of her own unemployment problem.

INTERNATIONAL TRADE

Assuming that the unemployment problem in the larger industrial countries can be solved, the revival of international trade involves : firstly, the creation of a mechanism which will bring about an effective balance between imports and exports, and secondly, the education of the international investor in such a fashion that international investment will be confined within reasonable and realistic limits.

The proper balancing of imports and exports cannot be secured by means of tariffs alone, and the correct solution would seem to be a combination of moderate tariffs together with a system of price control through the control of wages. This control of wages would be associated with measures for the control of profits on the lines already indicated.

The suggested scheme for controlling the general level of wages appears to possess many incidental advantages which commend its adoption quite apart from its merits as an instrument for the control of prices.

To make the scheme a success it is vitally important that the trend of wages in the more progressive countries should be upwards. An appropriate figure for the United States would be an annual increase in the general level of wages of about 5 per cent. This would enable other countries to adjust their own wage levels in such a way as to secure a balance between imports and exports, while still adhering to the principle that all wage adjustments should be upwards and not downwards.

The smooth working of the scheme will, of course, depend very largely on how far each country is prepared to accept the principle that a properly adjusted system of international trade is to everybody's advantage, and that it can only be secured by mutual co-operation. The old idea that international trade is a form of "beggar my neighbour" must be abandoned, as must also the idea that one's own unemployment problem can be solved by pushing it on to someone else.

UNEMPLOYMENT IN THE SMALLER COUNTRIES

The industrial development of the smaller countries cannot be secured by a system of tariffs alone. The only satisfactory solution is a combination of a moderate system of protective tariffs and low production costs. The employers in such countries must be prepared to see that the technical management is efficient, and that a monopolistic position is not used to secure excessive profits, and the workers must be prepared to accept such wages as are justified by the technical efficiency of the country as a whole.

The successful development of industry in these smaller countries will also depend greatly on the goodwill and on the assistance which may be given to them by their more powerful neighbours. A rising level of prices in the countries which tend to suffer from an excess of exports will be a factor of great importance, as it will enable the smaller countries to secure a balance between imports and exports without lowering their rates of wages.

ORGANIZATION FOR VICTORY

Victory in the struggle against unemployment, like victory in war, cannot be secured without a great national and international effort.

It is essential that the plans for victory should be well and truly made, that the objectives in view and the methods to

be employed in attaining them should be clearly understood, and that the community as a whole should co-operate in giving effect to them.

To achieve this end it is necessary to stimulate public interest in the problem, to provoke discussion on the causes of unemployment, and to clarify the issues and devize appropriate remedies. An adequate organization—An Association for the Cure of Unemployment we may call it—with branches all over the country would appear to be needed, and such an organization might stimulate the study, not only of unemployment, but of other economic problems as well.

The creation of an organization of this character would be a step forward of immense importance, and it is also of very great importance that the movement should secure the support of all people of goodwill, and particularly of those who possess special knowledge of these difficult and important matters.

It is also necessary to stress the importance of co-operation between all classes of the community and the need for subordinating individual interests where they conflict with the common good. Everybody should remember that they have duties as well as rights and that their neighbours have rights as well as duties.

CONCLUSION

In taking farewell of his readers the author desires to emphasize once more that he lays claim neither to originality nor to infallibility. The results at which he has arrived and the suggestions which he has put forward are doubtless capable of being improved upon, but there are two matters on which he is not disposed to compromize, the belief that unemployment can be cured and the hope that the democracies will achieve the strength of purpose which is necessary to secure that end.

APPENDIX

STATISTICAL DATA FOR GREAT BRITAIN 1924-37

THE STATISTICAL DATA which are available for Great Britain are less complete and less suited to our purpose than those which are available for the United States. It is necessary to explain therefore how the figures discussed in the text have been arrived at.

Attention may first be directed to the following comparison between the years 1907 and 1929, in which investment is given as a percentage of national income* :—

1907	..	12·2 per cent.
1929	..	7·2 ,,

Other authorities differ somewhat in regard to the actual figures, but it is generally agreed that there was a decline in the value of saving and investment of approximately the order indicated. It also seems to be generally agreed that this decline was due to a falling off in individual saving, particularly among the higher incomes.

Certain figures for national income are given by Colin Clark in an article in *The Economist*†.

Figures for "total investment" are contained in the same table. For our present purpose it is necessary to deduct from this figure of total investment the cost of repairs and maintenance, since this expenditure is paid for as one of the costs of production. It does not involve any addition to the value of capital equipment, and it is not therefore in the nature of a new investment and is not paid for out of savings.

Separate figures are given elsewhere by Colin Clark for

* Colin Clark: *National Income and Outlay*, p. 185.

† *The Economist*, Sept. 1938, p. 444.

maintenance and depreciation, but no sharp distinction is made between money which is actually spent on maintenance and money which is set aside to form reserves. It is stated* that the "Cost of merely maintaining intact the existing stock of capital had risen by 1935 to £394 millions a year", and it will be seen that this same figure is referred to elsewhere† as the value of maintenance and depreciation. It may therefore be inferred that what is here called repairs and maintenance can be identified with what Colin Clark calls maintenance and depreciation, and that this item is the difference between gross and net investment in fixed capital‡. It is the total of net investment which must be identified with total saving.

Income and investment for 1924 are taken from *National Income and Outlay*, the figures being adjusted slightly to bring them into agreement with the later figures in *The Economist*. For the purpose of computing averages, figures for 1925-28 are interpolated.

The figures resulting from these calculations are given in Table I and are plotted diagrammatically in Fig. III.

It will be seen that the mean value of investment was £M.370, or 7·7 per cent. of national income, which may be compared with the figure of $7\frac{1}{2}$ per cent. for the United States. If the five years of the depression are excluded, the mean value of investment for the remaining years was 9·6 per cent.

The next step is to sub-divide total saving, which is equal to total investment, into its component parts.

Government saving for 1924 is from Colin Clark, *National Income and Outlay*, p. 190, and for 1929-37 from *The Economist*, Sept. 1938, p. 444, "Government Surplus".

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* *National Income and Outlay*, p. 169.

† *Loc. cit.*, p. 185, note to table.

‡ *Loc. cit.*, p. 185, table 84.

TABLE I

SHOWING INCOME AND INVESTMENT IN GREAT BRITAIN 1924-37

Year	Income £M.	Gross Investment £M.	Repairs and Maintenance	Net Investment
1924 ..	4550	803	341	462
1929 ..	4994	823	368	455
1930 ..	4754	645	372	273
1931 ..	4441	511	382	129
1932 ..	4335	495	385	110
1933 ..	4440	539	388	151
1934 ..	4755	728	391	337
1935 ..	5052	846	394	452
1936 ..	5380	877	397	480
1937 ..	5734	893	400	493
Mean ..	4823			370

Business saving for the years 1924, 1929 and 1935 is from *National Income and Outlay*, p. 190, "Undistributed Profits". The difficulty about the years 1930-34 is that there is no reliable estimate of business dis-saving due to trading losses and liquidation, and it has been thought better to accept the estimates of government and individual saving for these years, and deduce business saving as the difference between total saving and other saving. The years 1936-37 have been dealt with in the same way.

Individual saving for the years 1924, 1929 and 1935 is the difference between total saving and other saving. The figures for 1929 and 1935 are £M.224 and £M.121 respectively,

and it has been assumed that individual saving for the years 1932-37 remained sensibly constant at £M. 120. The figures for 1930-31 are interpolated.

This method of approach leaves a good deal to be desired, but no better method appeared to be available, and the results serve to indicate the general trend of events with sufficient accuracy for our immediate purpose. The results are set out in Table II.

TABLE II

SAVING IN GREAT BRITAIN FOR THE YEARS 1924-37

Year	Income £M.	Total Saving £M.	Government Saving £M.	Government Saving %	Business Saving £M.	Business Saving %	Individual Saving £M.	Individual Saving %
1924	4550	462	56	1.2	186	4.1	220	4.8
1929	4994	455	91	1.8	138	2.8	226	4.5
1930	4754	273	55	1.2	28	.6	190	4.0
1931	4441	129	41	.9	−67	−1.3	155	3.5
1932	4335	110	72	1.7	−82	−1.9	120	2.8
1933	4440	151	96	2.2	−65	−1.5	120	2.5
1934	4755	337	110	2.3	107	2.3	120	2.5
1935	5052	452	103	2.0	228	4.5	120	2.4
1936	5380	480	103	1.9	257	4.8	120	2.2
1937	5734	493	103	1.8	270	4.7	120	2.1
Mean	4823	370	80	1.7	118	2.5	171	3.5

INDEX

Account, Balancing the international, 111
Accounting, International, 106
Accounts, Unbalanced international, 108
Agricultural problems, 135
" " in Europe, 139

Bank money, 27, 30
Banking System, 29
Borrowing by Government, 89
Business cycles, 37
" saving, 20, 22, 69
" " and its control, 85

Capital, 20
" , Flight of, 34
" , Working, 20
Changes in demand, 64
" " output, 64, 67
Consumption, Production and, 18
Control of building cycle, 47
" business saving, 85
" cumulative influences, 87
" individual saving, 84
" international investment, 104
" " trade, 118
" major cycle, 44
" minor " , 37
" over-saving, 142
" prices, 126
" profits, 124
" saving and investment, 82
" wages, 131
Costs of production and distribution, 121
Cumulative influences (persistence), 56
" " and their control, 87
Cycle, Building, 47
" , Long period, 48
" , Major, 39, 44
" , Minor, 37
Cycles, Business, 37
" , Control of, 44, 47

Debtor and Creditor, 119
Depressed areas, 49

Economic control, 15
,, doctrine, 13
,, identities, 24
,, policy, 14
,, problems, 11
Equalization of saving and investment, 70
Europe, Reconstruction of, 48
Exchanges, Variable, 116
Expenditure, income and output, 64
Exports and imports, 102, 112

Faith, a statement of, 11
Farmers' earnings, 137
Finance, International, 100
Flight from the land, 136
,, of capital, 34, 102
Flow of goods and purchasing power, 18
Fluctuating prices, 120
Fluctuations in agricultural output, 138
,, in trade, 37
Free trade, 112

Gold, 28
,, standard, 30
Government borrowing, 89
,, saving, 23
,, ,, in Great Britain, 80, 151.
,, spending, 91
Great Britain, Over-saving in, 79
,, , Statistical data for, 148
,, , Unemployment in, 79, 93

Hard core of unemployment, 61

Identities, Economic, 24
Import and export licenses, 112
Imports and exports, 102, 112
Income, Allocation of, 19

Income, expenditure and output, 64
,, , Measurement of, 19
Individual saving, 22, 69
,, ,, and its control, 84
Inflation, 33
,, , Danger of, 36
Insurance companies, saving by, 23
Interest, Influence of the rate of, 71
International accounting, 106
,, finance, 100
,, *investment*, 102, 104
,, trade, 107, 145
,, ,, and relative prices, 117
Inventories, 20
Investment, 21, 24, 57
,, and saving, 64
,, , Control of, 82, 104
,, , Definition of, 21
,, , Equalization of saving and, 70
,, , International, 102, 104
,, , Saving and output, 57
,, , Voluntary and involuntary, 65
,, , Worth-while, 68

Laisser faire, 15
Licences for imports and exports, 112
Low earnings in agriculture, 137

Monetary policy, 35
,, reactions, 21
Money, 27
,, , Bank, 27, 29, 40
,, , Paper, 31
Multiplier, The, 53

Output, income and expenditure, 64
,, , measurement of, 19
,, , saving and investment, 67
Over-saving and unemployment in Great Britain, 79, 80
,, ,, in U.S.A., 74, 80
,, as a cause of unemployment, 61
,, , Control of, 82

Panic Money, 102
Paper Money, 31
Plan or no plan, 15
Policy, Economic, 14
,, , Monetary, 35
,, regarding prices, 120
,, ,, wages, 128
Price-level and its control, 119
Prices and international trade, 117
,, , Control of, 126
,, , Fluctuating, 120
,, , Wages and, 122
Production and Consumption, 18
Profit, 122
Propensity to save, 71
Public works, 41
Purchasing power, Flow of, 18
,, ,, , Remedy for loss of, 73

Quotas, 146

Reconstruction of Europe, 48
Relative prices and international trade, 117

Save, Propensity to, 71
Saving, 21, 22, 69
,, and investment, 64
,, , Business, 22, 69
,, , ,, , Control of, 85
,, , ,, , in Great Britain, 80, 151
,, , ,, , in U.S.A., 77
,, , Control of, 73, 82
,, , Definition of, 21
,, , Government, 23
,, , ,, , in Great Britain, 80, 151
,, , Individual, 12, 84
,, , ,, , in Great Britain, 80, 151
,, , ,, , in U.S.A., 76
,, , investment and output, 67
Silver, 28

Small country and its difficulties, 109, 146
Specific unemployment, 16, 49
Spending by government, 91
Subsidies, 116
Tariffs, 113
Trade, International, 107, 145
Trading deficit, 25
„ surplus, 25
Transfer of workers, 51

Unemployment, due to foreign competition, 17
„ , due to over-saving, 16, 61, 82
„ , Intermittent, 16, 27
„ , Specific, 16, 49
„ , Types of, 16
„ , in Great Britain, 79
„ , „ , Cure of, 93
„ , in U.S.A., 74
„ , „ , Cure of, 95, 144

Variable exchanges, 116
Voluntary and involuntary investment, 85

Wages : existing methods, 128
„ : the trend should be upwards, 132
„ and prices, 122
„ and the cost of living, 130
„ , A new method of adjusting, 131
„ scheme inaction, 133
„ tribunal, 133
Worth-while investment, 68